DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

URUGUAY

SOCIAL PROTECTION AND SUSTAINABILITY

Operation No. 1417-UR
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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

URUGUAY

SOCIAL PROTECTION AND SUSTAINABILITY PROGRAM

(UR-0151)

LOAN PROPOSAL

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ABBREVIATIONS

AFAPs	Pension Fund Administrators
ANEP	National Public Education Administration
APAL	Secondary School Parents Association
ASSE	State Health Services Administration
ATPS	Technical Advisory on Social Policies
BPS	Social Security Bank
DSS	Health Services Division
ECLAC	Economic Commission for Latin America and the Caribbean
GDP	Gross domestic product
IAMC	Group Medical Care Institutions
IDB	Inter-American Development Bank
IMF	International Monetary Fund
INE	National Statistics Institute
IRIC	Tax on Industrial and Commercial Income
IRP	Personal Income Tax
MEF	Ministry of the Economy and Finance
MEMFOD	Secondary School and Teacher Training Modernization Program
MSP	Ministry of Public Health
OC	Ordinary Capital
OPP	Office of Planning and Budget
PAE	School Food Program
PAI	Expanded Immunization Program
PSP	Priority Social Program
SAL	Sector Adjustment Loan
UCP	Program Coordinating Unit
WB	World Bank

INTER-AMERICAN DEVELOPMENT BANK
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URUGUAY

IDB LOANS

APPROVED AS OF JUNE 30, 2002

	US$Thousand	Percent
TOTAL APPROVED	**2,820,690**	
DISBURSED	2,166,814	76.8%
UNDISBURSED BALANCE	653,876	23.2%
CANCELLATIONS	250,026	8.9%
PRINCIPAL COLLECTED	655,569	23.2%
APPROVED BY FUND		
ORDINARY CAPITAL	2,674,774	94.8%
FUND FOR SPECIAL OPERATIONS	104,079	3.7%
OTHER FUNDS	41,836	1.5%
OUSTANDING DEBT BALANCE	**1,511,245**	
ORDINARY CAPITAL	1,478,986	97.9%
FUND FOR SPECIAL OPERATIONS	32,259	2.1%
OTHER FUNDS	0	0.0%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	278,411	9.9%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	433,984	15.4%
ENERGY	116,503	4.1%
TRANSPORTATION AND COMMUNICATIONS	328,894	11.7%
EDUCATION	146,438	5.2%
HEALTH AND SANITATION	398,552	14.1%
ENVIRONMENT	0	0.0%
URBAN DEVELOPMENT	269,434	9.6%
SOCIAL INVESTMENT AND MICROENTERPRISE	85,533	3.0%
REFORM _PUBLIC SECTOR MODERNIZATION	646,030	22.9%
EXPORT FINANCING	8,940	0.3%
PREINVESTMENT AND OTHER	107,972	3.8%

***** Net of cancellations with monetary adjustments and export financing loan collections***

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URUGUAY

STATUS OF LOANS IN EXECUTION AS OF JUNE 30, 2002

(Amounts in US$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED	AMOUNT DISBURSED	% DISBURSED
Before 1996	2	99,000	91,621	92.55%
1996 - 1997	6	442,900	353,107	79.73%
1998 - 1999	5	309,900	187,829	60.61%
2000 - 2001	7	347,425	94,149	27.10%
2002	1	180,000	0	0.00%
TOTAL	21	$1,379,225	$726,706	52.69%

* Net of Cancellations . Excluding export financing loans.

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URUGUAY

IDB PRIVATE SECTOR "A" LOANS

APPROVED AS OF JUNE 30, 2002

	US$Thousand	Percent
TOTAL APPROVED	**12,000**	
AMOUNT APPROVED AND SIGNED	12,000	100.0%
DISBURSED	12,000	100.0%
UNDISBURSED SIGNED LOANS	0	0.0%
AMOUNT APPROVED AND NOT SIGNED	0	0.0%
CANCELLATIONS	0	0.0%
PRINCIPAL COLLECTED	5,000	41.7%
APPROVED BY FUND		
ORDINARY CAPITAL	12,000	100.0%
OTHER FUNDS	0	0.0%
OUSTANDING DEBT BALANCE	**7,000**	
ORDINARY CAPITAL	7,000	100.0%
OTHER FUNDS	0	0.0%
APPROVED BY SECTOR		
AGRICULTURE AND FISHERY	0	0.0%
INDUSTRY, TOURISM, SCIENCE TECHNOLOGY	0	0.0%
ENERGY	0	0.0%
TRANSPORTATION AND COMMUNICATIONS	12,000	100.0%
EDUCATION	0	0.0%
HEALTH AND SANITATION	0	0.0%
ENVIRONMENT	0	0.0%
URBAN DEVELOPMENT	0	0.0%
SOCIAL INVESTMENT AND MICROENTERPRISE	0	0.0%
REFORM _PUBLIC SECTOR MODERNIZATION	0	0.0%
EXPORT FINANCING	0	0.0%
PREINVESTMENT AND OTHER	0	0.0%

***** Net of cancellations with monetary adjustments and export financing loan collections*

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URUGUAY

STATUS OF LOANS IN EXECUTION AS OF JUNE 30, 2002

(Amounts in US$ thousands)

APPROVAL PERIOD	NUMBER OF PROJECTS	AMOUNT APPROVED *	AMOUNT DISBURSED	% DISBURSED
REGULAR PROGRAM				
Before 1996	2	99,000	91,621	92.55%
1996 - 1997	6	442,900	353,107	79.73%
1998 - 1999	5	309,900	187,829	60.61%
2000 - 2001	7	347,425	94,149	27.10%
2002	1	180,000	0	0.00%
TOTAL	21	$1,379,225	$726,706	52.69%

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Uruguay

Tentative Lending Program

2002

Project Number	Project Name	IDB US$ Millions	Status
UR0136	Multesectoral Finance Global Program	180.0	APPROVED
UR0151	Social Protection and Sustainability Program	320.0	
UR0139	RTC Improvement Municipal Management IMM	3.0	
UR0134	Infancy, Adolescent & Family At Risk	40.0	
*UR0142	Port of M'bopicua	13.6	
	Total - A : 5 Projects	**556.6**	
UR0131	Municipal Development and Management	70.0	
*UR0148	Port of Montevideo	12.2	
UR0150	Financial Sector Loan	200.0	
	Total - B : 3 Projects	**282.2**	
	TOTAL 2002 : 8 Projects	**838.8**	

2003

Project Number	Project Name	IDB US$ Millions	Status
UR0147	Legislature Administrative Strengthening	3.9	
UR0135	Highway Infrastructure	160.0	
UR0141	Cattle Development Program	32.0	
	Total - A : 3 Projects	**195.9**	
	TOTAL - 2003 : 3 Projects	**195.9**	

Total Private Sector 2002 - 2003	**25.8**
Total Regular Program 2002 - 2003	**1,008.9**

*** Private Sector Project**

SOCIAL PROTECTION AND SUSTAINABILITY PROGRAM

(UR-0151)

EXECUTIVE SUMMARY

Borrower and guarantor:	The Eastern Republic of Uruguay	
Executing agency:	Ministry of Economy and Finance (MEF) in coordination with the Planning and Budget Office (OPP)	
Amount and source:	IDB: (OC – Emergency Lending Program	US$500 million
	Total::	US$500 million
Financial terms and conditions:	Amortization period:	5 years
	Grace period:	3 years
	Disbursement:	12 months
	Interest rate:	Six-month Libor in US$ plus 400 basis points per year
	Front-end fee:	1%
	Credit fee:	0.75%
	Currency::	United States dollars under the Single Currency Facility

Objectives: The program objective will be to support the Government of Uruguay in providing budgetary protection for priority social programs (PSPs) in education, health, and social security, while simultaneously ensuring the sustainability of modernization efforts now in progress in these social sectors, so as to prevent the ongoing economic crisis from having an adverse impact on the poorer population groups, a deterioration in the country's social indicators, and a reversal in the ongoing modernization efforts aimed at enhancing the efficiency and equity of access to the social benefits on the part of needy groups.

Description: The program will include three action areas: (i) monitoring agreements with the International Monetary Fund (IMF) aimed at maintaining a stable macroeconomic framework; (ii) budgetary protection of the PSPs in the areas of education, health, and social security; and (iii) sustainability of the progress made in modernizing education, health, and social security.

Monitoring agreements with the IMF aimed at maintaining a stable macroeconomic framework: The last three years of recession affecting the Uruguayan economy, largely of international origin, combined with the recent contagion effect which is also internationally triggered, has had an impact on Uruguay's ability to achieve some basic macroeconomic equilibria. For this reason, and in conformity with the logic of this operation, it is necessary to monitor the recent Stand-by Arrangement between the Uruguayan authorities and the IMF for the 2002-2004 period, the chief aim of which is to restore macroeconomic equilibrium and lay the groundwork for revitalizing the Uruguayan economy (see paragraphs 2.4 to 2.6).

The impact of such monitoring is expected to contribute to compliance with the macroeconomic objectives that will lead to an environment conducive to a revitalization of production and a rebound in employment levels, in the context of financial assistance to Uruguay granted by the international community, multilateral credit agencies, and development institutions.

Budgetary protection of the PSPs in education, health, and social security: The overall level of public spending, including social spending, has been cut back significantly as a result of the fiscal adjustment needed to restore Uruguay's basic macroeconomic equilibria and establish a sound basis for the sustained growth of its economy (Fiscal Responsibility Law of February 2002 and Fiscal Stability Law approved in May 2002). The economic authorities have undertaken to ensure that these programs will be budgetarily protected and will not be scaled back in the event that a further adjustment proves necessary.

This area of program action is focused on budgetary protection for the nonwage spending levels of the PSPs, the selection of which is dependent on their targeting the neediest segments of the population and the most vulnerable groups such as children, mothers, the unemployed, and the elderly. Moreover, in some special cases, such as the PSPs in health, projects were selected because they constituted a public good with positive externalities for the population as a whole. A further criterion in the selection of PSPs relates to the strategic nature of some of the modernization efforts under way, as in the case of the lower secondary education program, the program to modernize the health sector, and the social security reform (see paragraphs 2.7 to 2.12).

The expected impact of budgetary protection for the PSPs in education, health, and social security is to contribute to mitigating the negative impact on the poorest population groups of any further fiscal adjustments, by maintaining the budgetary protection of PSP expenditure in 2002 and 2003.

Sustainability of the progress made in modernizing education, health, and social security: In the context of an unfavorable economic scenario there is a tendency to postpone important modernizations in the social sectors, for which reason this action area in the program is aimed at sustaining modernization efforts in progress in the education, health, and social security sectors (see paragraphs 2.13 to 2.16).

The expected impact of this policy area is to contribute to preventing any setbacks in the modernization policies aimed at enhancing efficiency in the management of the education, health, and social security sectors, as well as equitable access to these social benefits. This, in conjunction with the budgetary protection of PSPs, will help prevent deterioration in the situation of the poorest in terms of the benefits and payments they receive at present, as well as to avoid deterioration in Uruguay's social indicators in the critical economic conditions currently prevailing.

The Bank's country and sector strategy:

The key objective of the Bank's strategy in Uruguay is to support the government's development programs and policies for the five year period from 2000 to 2004, which are aimed at achieving, within a framework of macroeconomic sustainability, sustained growth in gross domestic product (GDP) and greater social equity. In more operational terms, the Bank's strategy focuses on: (i) supporting initiatives to enhance the competitiveness of national production in the regional and international sphere, and promote private investment on the basis of sustained production in areas of comparative advantage and the incorporation of modern technology, with a view to creating sound competitive conditions that will lead to greater involvement in the regional and international markets; (ii) supporting further advances in the process of transforming and modernizing the State to reduce its weight in the economy, increase its efficiency, streamline and target its intervention, and decrease its impact on the costs of national production of goods and services; and (iii) supporting efforts to improve social welfare and increase equity, by incorporating the most vulnerable groups into the development process and improving the quality of life.

Given the adverse international economic circumstances currently affecting the country, this Social Protection and Sustainability Program is part of the strategic dimension of improving social welfare and enhancing equity, which guide the Bank's efforts in Uruguay.

Environmental and social review: In view of the special characteristics of the program, which will provide budgetary support for expenditure on existing social initiatives, it is not expected to have any direct environmental impact, and consequently there are no new actions that might require an environmental impact assessment (see paragraph 4.4).

Benefits: The benefits of the program relate directly to its objectives, which are aimed at supporting the government's efforts to conserve the long-standing tradition of social cohesiveness in Uruguay and keep the effects of the financial crisis being experienced by the country from principally affecting the poorest and most vulnerable population groups. To this end, the program, within the framework of Uruguay's arrangements with the IMF aimed at restoring a stable macroeconomic framework, will apply clear targeting criteria to protect PSPs in education, health, and social security. Moreover, the set of actions in support of the program in the area of social policies will mean not just avoiding reversals that could be negative, but also taking major strides to achieve better targeting and enhanced efficiency in the management of the social services provided to the population.

Risks: There is a risk that the financial crisis will flourish anew and generate greater pressures to adjust the budget, which could prompt even greater cutbacks in public spending. This situation might not only mean further budgetary reallocations in each of the social sectors as well as additional cuts in other non-targeted social programs, but also force cuts in the protected PSPs, which would ultimately impact the program objectives both in terms of the protection sought for the most vulnerable population groups, and in terms of the impossibility of supporting Uruguay's international reserves position should it not be possible to disburse resources from the second tranche in a timely manner. This risk would be mitigated in that total budgetary protection amounts to 10% of consolidated public expenditure, a proportion which suggests that it is reasonable to maintain budgetary protection in the future if the Government of Uruguay effectively prioritizes social spending. It is further mitigated in the context of the government's new arrangements with the IMF and the international financial community, which seek on the one hand to generate the conditions required for the country to return to the path of sustained economic growth, and on the other hand to protect the economy from further contagion produced by the turbulent regional economic climate. Moreover, the Bank will closely monitor economic events in Uruguay and the progress made in complying with the agreements reached in the framework of this operation, using for this purpose the progress reports agreed upon with the executing agency, which will include bimonthly benchmarks to assess progress, thereby making it possible to maintain a flexible and timely dialogue on the status of program execution.

Special contractual clauses: Disbursement of the resources corresponding to each tranche will be subject to fulfillment with the policy actions agreed for the tranche concerned, as specified in chapter II and in Annex II-1 to this loan document.

For the specific case of the first disbursement, additional prior conditions will be: (i) the opening of a special account for managing the program financing resources; (ii) effective operation of the Program Coordinating Unit (UCP) under the MEF, with the staff previously agreed upon with the Bank for the proper execution of the program; and (iii) signature of the project execution agreements between the MEF and the OPP and the sector agencies (National Public Education Administration (ANEP), Ministry of Public Health (MSP), and Social Security Bank (BPS)).

Poverty-targeting and social sector classification: Although it does protect social spending and strengthens modernization efforts in the social sectors, in accordance with the operational guidelines for such special programs (GN-2031-10), this operation does not qualify as poverty-targeted or social equity-enhancing (see paragraph 4.5).

Exceptions to Bank policy: None.

I. FRAME OF REFERENCE

A. Macroeconomic overview

1.1 Uruguay has maintained a strategy of economic openness to the rest of the world and structural reforms, an environment in which the Uruguayan economy has experienced satisfactory growth with declining inflation during almost all of the 1990s. The policy of combating inflation by using the exchange rate as the nominal anchor of the pricing system, in conjunction with strict control over public finances, was successful in reducing the annual growth rate of prices to 3.6% in 2001, thereby achieving the lowest inflation rate in the past 50 years. However, spending continued to exert financial pressures on the public sector throughout the decade. Consequently, fiscal deficits were incurred for most the 1990-1998 period, despite the 1995 tax package, which increased the tax ratio, and the public enterprise pricing policy. These made it possible to narrow the gap between revenue and expenditure, and to achieve a fiscal deficit of 0.9% of gross domestic product (GDP) in 1998. The prudent management of public finances and a favorable external climate made it possible to achieve real GDP growth averaging almost 4% per annum in 1990-1998.

1.2 To strengthen public finances and decrease the effects of the burden posed by the state on the production costs of private firms, the government has introduced a number of structural reforms, the most prominent of which are: (i) the Central Administration, to decrease the cost and enhance the efficiency of its management; (ii) social security, which is striving to modify the pay-as-you-go (PAYG) [reparto] arrangement and replace it by a mixed system with two pillars (PAYG and individual saving) in order to decrease the social security deficit and generate private long-term savings; (iii) education, by improving its efficiency, quality, and coverage; and (iv) the health sector, to fine-tune the regulatory framework and strengthen the public and private health subsystems.

1. Recent trends

1.3 The economic situation has been worsening since 1999. Uruguay’s economy experienced a period of recession, with a cumulative decline of 7.5% of GDP during 1999-2001. Particularly in 2001 and early 2002, Uruguay’s economic problems were compounded owing to the Argentine economic and financial crisis, with a decline in real GDP of 3.1% in 2001 and 10.1% in the first quarter of 2002 as compared to the same period of the previous year. This recession was associated with: (i) deterioration in the terms of trade; (ii) devaluation of the Brazilian real in 1999 and its adverse impact on trade with Brazil; (iii) the foot-and-mouth disease epidemic which caused a temporary closure of the export markets for Uruguayan meat in 2001; and (iv) the prolonged recession and subsequent institutional and financial crisis in Argentina, which is affecting the demand for goods and tourist flows to Uruguay, and exerting pressures on the Uruguayan financial system. When the Argentine peso ceased to be convertible in early 2002, Uruguay sped up the pace of its monthly devaluation of the peso and broadened the crawling band, recently adopting the free floating of its currency.

1.4 In view of these trends, Uruguay's unemployment rate rose from 11.3% in 1999 to 15% in the first quarter of 2002; the trade balance continued to run a deficit; and public finances deteriorated, making it necessary, in response to the slower pace of economic activity, to reduce spending, including investment expenditure, and to apply a restrictive wage and public utility rates policy in order to reduce its deficit. Nevertheless, the deterioration in the situation in Argentina had a negative impact on domestic private demand, resulting in a shortfall in tax receipts and an increase in the fiscal deficit beyond programmed levels. The consolidated public sector deficit was about 4.0% of GDP in the period 1999-2001.

1.5 Owing to the persistence of the consolidated deficit of the public sector and the increase in the level of debt to finance it, in February 2002 Uruguay lost the nonspeculative "investment grade" ranking it had received since 1997, which triggered an increase in country-risk. The public debt in dollars, expressed in terms of GDP, rose from 34.4% in 1998 to 52% in 2001, owing to: (i) the public sector borrowing requirements; (ii) the more rapid rate of depreciation of the peso against the dollar; and (iii) the increase in international reserves for precautionary reasons because of the instability in the region.

1.6 The pressures on public finances have continued subsequently in 2002, making it necessary for the government to introduce new tax and austerity measures for the purpose of containing the fiscal deficit at 2.5% of GDP. In February, Parliament approved an adjustment, the Fiscal Responsibility Law, which sought to increase revenue and reduce spending in an amount equivalent to three percentage points of GDP by end-2002. With the worsening of the situation in Argentina, these measures did not achieve the anticipated yield, as a result of which a new fiscal package (the Fiscal Stability Law) was approved in May in an amount equivalent to 1.5% of GDP, with effect until January 2004, which includes the increase in the Personal Income Tax (IRP) on both wages (public and private) and pensions, and an increase in the rates of the Industrial and Commercial Income Tax (IRIC). In addition to these fiscal measures, the government is introducing a structural reduction in public spending which would enter into force in January 2003, upon approval of the next Budget Closure Law.

2. Agreement with the International Monetary Fund (IMF)

1.7 The government's strategy to try to achieve growth with price stability has been supported by Stand-by Agreements with the IMF. The agreement approved in March 2002 covers the period from March 1, 2002 to March 31, 2004 and entails support in the amount of SDR 594.1 million (approximately US$745 million), of which about US$140 million has been disbursed so far. The primary targets under this agreement are: (i) an inflation rate, calculated on a December-to-December basis, of about 10%; (ii) reduction of the public sector deficit from 4.2% of GDP in 2001 to 2.5% of GDP in 2002; and (iii) maintenance of the monthly rate of devaluation of the peso at 2.4% until end-2002.

1.8 Subsequently, in late May, the government requested that the IMF increase the existing agreement by SDR 1.16 billion (approximately US$1.5 billion) in the context of the measures being implemented to protect the Uruguayan banking system from international contagion. In these circumstances, the national authorities and the IMF revised the existing letter of intent on the basis of a projected decline in real GDP of 7% in 2002. The revised letter of intent was approved by the IMF Executive Board on June 24, 2002. The new letter of intent changes some aspects of the earlier agreement, including: (i) a slightly higher projected inflation rate of 11.5%; and (ii) modification of the exchange rate policy, by adopting a freely floating currency agreement.

1.9 The economic program includes a series of actions, including: (i) creation of the Banking System Strengthening Fund in order to provide liquidity or meet possible capitalization needs of the banks; (ii) strengthening of public finances, including a tax reform to be submitted to Parliament at end-2002; and (iii) the opening to private initiative of activity sectors that had previously been reserved for the public sector, including new regulatory frameworks for the electricity, telecommunications, and transport sectors, and the awarding of more concessions to private business.

3. Recent Trends in the Financial Sector

1.10 During the first six months of 2002, the Uruguayan economy experienced the effects of a crisis of confidence, linked to the crisis in Argentina, which affected adversely the banking system through a run on bank deposits and the associated drop in foreign exchange reserves of the Central Bank. Confronted with this situation the Government of Uruguay adopted several measures with the purpose of restoring investors' confidence in the financial market. Among the measures implemented are: (i) the aforementioned increase in the current IMF stand by agreement, and (ii) the capitalization of Banco Comercial. Nevertheless, the deposit run continued and deepened in July (by end-July BCU's reserves stood at US$655 million). In response, the Government imposed a banking holiday and suspended the activities of two banks (Montevideo and Caja Obrera).

1.11 Given the worsening situation, the government has adopted additional measures through a Banking Sector Strengthening Law, already approved by Parliament, which restructures banks' operations. The law includes the reprogramming of fixed term dollar deposits in public banks, estimated at US$2.400 million, over a three-year period.

1.12 In this context, the IMF is leading an increase in multilateral financial assistance to cover the additional financial gap (estimated at US$1,275 million). The IMF would provide US$500 million and the Bank would increase the original amount in the Social Protection and Sustainability Program by US$180 million. The World Bank would contribute US$150 million. These resources will allow for the return of the bridge financing operation effected by the US Government in support of the Uruguayan financial system.

4. Outlook

1.13 In accordance with the financial program of the government, it will have sizable financing requirements which will be funded principally by international organizations. These resources will be used to: (i) strengthen the banking system; (ii) meet debt service commitments in 2002 and 2003; and (iii) partially restore the level of international reserves. The success in the strenghtening of the banking system would contribute to the recovery of the confidence of the economic agents in the country and it would help to mitigate the actual financial turbulence.

1.14 Public sector finance developments in 2002 are closely tied to improvements in the situation of external markets and their impact on economic activity in the country. In this context, it is estimated that the fiscal policy now in place will reduce the fiscal deficit to 2.5% of GDP.

1.15 In the short term, Uruguay must cope with a regional environment that is complicated by the prolonged crisis in Argentina, which has a serious impact on the Uruguayan economy. This situation compounds the effect of the slackening of domestic demand resulting from credit contraction and the drop in household incomes, the outgrowth of increased debt service, and the deterioration in the terms of trade. In this environment, it is estimated that real GDP will further decline in 2002 by about 7%, with an increase in the unemployment rate from that of 2001. Overall exports are projected to increase somewhat from the 2001 level given that the combined impact of the collapse of the Argentine market and the shortfall in tourism revenues will be offset by an increase in exports to countries outside the region and possibly to Brazil, owing to the more sizable devaluation of the peso and the resumption of meat exports now that foot-and-mouth disease has been brought under control. Imports will decline in value terms owing to the decrease in domestic demand and the free floating of the peso. As a result, the trade deficit will be reduced, and the current account is projected to be in balance for the current year.

1.16 In a longer-term perspective, the continuation of economic policies conducive to the dynamic growth of private investment, reflected in particular in the fiscal prudence characterizing the steps taken by the economic authorities, combined with an environment of enhanced competitiveness and relative price stability, will ensure that the anticipated greater dynamism of the Uruguayan economy will prove to be viable.

B. Social situation

1. Poverty and social inequality

1.17 Uruguay, with its population of 3.3 million, has highly favorable social indicators: 90% of the population completes the six years of primary education, a level exceeding the average for the region and on its way to matching that of the developed countries; at the same time, infant mortality (14.1 per 1,000 live births) is one of the lowest in the region. Furthermore, poverty and absolute poverty levels are historically low. Estimates for 1998 indicate that 11.9% of Uruguayans were living below the poverty line[1] and that 2% were in absolute poverty, while the coefficient of concentration (Gini coefficient) was 0.44, which compares favorably with the 1990 indicator of 0.49. The percentage of the population with unmet basic needs is low; the coverage of education is relatively high, and access to health, water, sanitation, and electricity services is virtually universal.

1.18 However, the tendencies and characteristics identified for the poor are similar to those for neighboring countries in the region: low education levels, larger families, with a higher rate of dependency and a higher proportion of single-parent households headed by women. Moreover, given the low population growth rates compared to neighboring countries, approximately 40% of the children now being born in Uruguay are born to poor families.

1.19 Access to basic social services is also more precarious for the poor. In general, they live in inadequate housing, with high crowding levels and deficiencies with regard to sanitation services. While it is not possible to identify any gender differences in respect of school attendance, the children of poor families are less likely to complete secondary school. The majority of the poor use public health services, which are generally regarded as being of a lower standard than the services of the private subsystem of Group Medical Care Institutions (IAMCs). This said, recent surveys conducted in Uruguay indicate user satisfaction with the service received when access is gained.

2. Social spending by the government

1.20 Uruguay's social policies are progressive and there is an ample range of social protection programs which, however, quite recently have begun to make adjustments to the demographic and economic changes that have taken place. In addition to the virtually universal coverage of primary education and health, in the area of social security and welfare there are non-contributory economic payments made to poor families, the unemployed, the children of single-parent households headed by women, and the elderly, which constitute the most vulnerable population

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[1] Data from the Economic Commission for Latin America and the Caribbean (ECLAC).

groups. Other social programs target child development, school nutrition, youth training, and rural housing.

1.21 From the standpoint of resources allocated to this social effort, it should be noted that consolidated public spending corresponded to 31.5% of GDP in 2000, of which 74% was for social public spending,[2] a figure that is the highest in the region at 23.5% of GDP. Within this structure of spending shares for 2000, education (7.1%), health (5.8%), and social security and welfare (60.9%) have the largest relative weight.[3]

1.22 The internal composition of this spending varies by sector. In education, the majority of such spending is devoted to paying staff compensation (85%), while in health the majority is for operating costs and supplies (59.2%). In the social security area, the greatest relative weight is that of transfers for contributory pensions (83%).

1.23 Looked at over time, spending on education, health, and social security tended to increase between 1993 and 1999, but significant declines can be observed beginning in 2000. In a comparison expressed in real terms, the reduction in the projected 2002 budget for the National Public Education Administration is 9.3% from the level in the executed budget for 1999. The cutback in the budget of the Ministry of Public Health (MSP) is 13.2% for the same period, while for the Social Security Bank (BPS) the reduction was 14%. For the same period, the reduction in the social spending budget is some 11.1% in real terms, while the decline in the consolidated public spending budget is about 9.7%. In this connection, the following table summarizes the changes in real terms in the executed budget for sectoral public spending, social public spending, and consolidated government expenditure.

Table I-1: Budget Execution by Sector (in millions of 2002 U.S. dollars)*

SECTOR	1999	2000	2001	2002
Education (ANEP)	427	407	426	387
Health (MSP)	247	256	254	215
Social Security (BPS)	2,424	2,359	2,308	2,083
Social Spending	3,617	3,539	3,474	3,216
Consolidated Public Expenditure	5,082	4,812	4,715	4,590

Note: * Average 2002 exchange rate estimated at Ur$17 per U.S. dollar

[2] This spending corresponds to that for education, health, social security and welfare, housing and community services, and other social services.

[3] *El Gasto Público Social en Uruguay: una aproximación a su estudio y cuantificación* [Social Spending in Uruguay: An Approach to its Study and Quantification], Technical Advisory on Social Policies, Office of Planning and Budget (OPP), mimeograph, April 2002.

3. Education, health, and social security sectors

a. Education

1.24 In Uruguay, public education at the preschool, primary, and secondary levels is the responsibility of ANEP, an autonomous state agency, and not the Ministry of Education. Its educational system is organized as follows: two years of preschool, six years of primary education (1st to 6th) and three years of the basic cycle of secondary education (1st to 3rd), which are mandatory, and three years of the second cycle of secondary education (4th to 6th). In recent years, Uruguay has been making decisive investments to improve the quality, coverage, and student retention capacity of its educational system. At the preschool level, access to the population aged four to five has rapidly been universalized. In primary school, coverage is also virtually universal (96%) and almost 90% of the population completes the six years of primary education. The situation is somewhat different in the schools situated in poor sectors, where there are high percentages of failing students (high absenteeism from class and repeating grades, with repeat ratios in 1st grade of 38%) and problems of unmet social needs.

1.25 At the secondary level, the situation is different. While extremely significant progress has been made in broadening access to the basic cycle (the gross enrollment ratio is about 85%), net coverage is only 70%, which is explained by high grade repetition ratios and students' dropping out. The low school retention capacity means that only half the relevant age group manages to complete the basic cycle, and only one of three students completes secondary school. Consequently, it is of fundamental importance to continue improving the internal efficiency of the system, that is, to reduce the number of years it takes a student to complete the educational cycle.

b. Health

1.26 Uruguay's health system has virtually universal coverage. The population accesses services through two subsystems: the private subsystem, financed by social security contributions, voluntary contributions to prepaid medical care entities, private insurance, and direct user payments; and the public subsystem, for the most part financed by general revenues. The public subsystem operates through the State Health Services Administration (ASSE), a network of medical centers and hospitals that provides medical care to approximately a third of the overall population, including workers in the informal sector, low income individuals without social security coverage, or those who have lost their coverage or lack the resources to make the co-payments collected by the prepaid health institutions, as in the case of the unemployed and their family groups.

1.27 This public subsystem is focused in particular on the inclusion of the poor.[4] Although the public healthcare network is open to Uruguay's entire population, there are clear targeting mechanisms that have been undergoing fine-tuning in recent years. Users of the public services are identified and classified on the basis of their income level, the type of coverage they have, and other characteristics. Once patients are identified as being affiliated with private institutions, the IAMC or private insurance, they are given the same care and payments are subsequently made by the institutions responsible for their medical coverage.

c. Social security

1.28 The social security system, administered by the BPS, carries out a range of programs most of which target workers in the formal sector and their families. The most important of these is the system of contributory pensions. The system, reformed in 1996 with support from the Bank (Loan 921/OC-UR), is based on two fundamental pillars: solidarity among generations, and individual savings accounts. All workers in the formal sector are required to contribute to the first pillar, administered by the BPS, with a minimum 7.5% of their first Ur$10,760 of monthly income and may deposit the other 7.5% in their respective individual accounts or keep it in the PAYG. Above this base, the incomes of workers earning between Ur$10,761 and Ur$32,278 a month are required to contribute 15% to an individual capitalization system, administered by Pension Fund Administrators (AFAPs). Finally, employees with incomes exceeding Ur$32,279 a month make voluntary savings contributions in respect of the income exceeding that monthly level.

1.29 With this kind of operational logic, the new system is confronting areas of instability which could jeopardize its consolidation in the medium and long term. Given that the revenue projections for the individual savings option have exceeded all expectations (in 2001, almost 100% of those eligible to do so were affiliated with this new option), there has been an increase in the financial assistance requirements of the BPS. To suspend such assistance would threaten the sustainability of the new system and trigger pressures on public finances which the reform itself was intended to eliminate in the medium and long term. Should this prove to be the case, it would jeopardize the aims of the individual capitalization pillar, which would incite a lack of confidence on the part of contributors that would be converted into a lessening of the economic and institutional viability of the new comprehensive pension system in Uruguay.

1.30 Alongside its own budget, the BPS also administers a range of benefits for contributors and noncontributors, financed by current revenue, third-party resources and state contributions, which include: (i) unemployment insurance, financed in its

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[4] According to the Continuous Household Survey of 1998, approximately 87% of the population in the poorest decile and 78% in the second decile are covered by ASSE and other public institutions, and 69.2% of the expenditure of the Ministry of Public Health benefits the first two quintiles.

entirety by fiscal contributions; (ii) economic assistance and healthcare services program which originally covered only the families of those employed in the formal sector and paying into the system, and in recent years has been broadened and reformed to include the unemployed, low-income households, and single parent households headed by women; (iii) old age and disability pensions, available to low income adults over the age of 70 or with handicaps; and (iv) small social development programs for retirees and pensioners. These benefits were established at various different times by various public institutions, and their administration consolidated within the BPS over time.

4. Recent sectoral modernization efforts

1.31 In education, Uruguay has made important strides in improving the equity and quality of education in recent years, offering new opportunities for accessing and remaining in the educational system. In this framework, one of the actions being carried out with noteworthy success in the context of the educational reform is the School Food Program (PAE), the aim of which is to contribute to the proper nutritional state of the school-age population, with special emphasis on those children in risk situations. At present, the PAE provides nutritional supplements to 45% of the children attending public schools throughout the country. However, recent studies have demonstrated the need to improve the targeting of the food service provided, that is, the extent to which the children who need to participate in the program (those situated below the 20th percentile for the anthropometric indicators of weight/age, height/age, and weight-height/age) actually do so. As one way of initiating steps to improve its targeting, the ANEP has decided to apply a Height Census reflecting the nutritional status of all students in the 1st grade of primary education (approximately 57,800 students), the results of which will make it possible more accurately to identify the target population, the nutritional impact of the program, and the program's effectiveness and efficiency levels.

1.32 Another modernization measure that needs to be strengthened is the participation of parents in Uruguay's technical institutes and schools. At present, for primary education, parents participate through the Development Commissions, which directly finance the hiring of service aides to provide cleaning services in the public schools, while the Auditor-General's Office takes care of paying employer contributions. Considering the success of this experiment, it has been decided to extend the measure for secondary and technical education, thereby strengthening a better tie between the community and these educational centers as well as committing parents to greater involvement with the administration of these educational facilities.

1.33 At the same time, and with Bank support, Uruguay is developing a package of reforms to broaden youth access to secondary education that is more relevant to its needs and to the requirements of citizenship and the world of work in the 21st century. This support is reflected in the Program to Modernize Secondary

Education and Teacher Training (MEMFOD, Loan 1361/OC-UR), the fundamental aims of which are to consolidate the universalization of the first cycle of secondary education, which completes the nine years of mandatory schooling, and transforming the second cycle of secondary education by laying the groundwork for its institutional and curricular reform.

1.34 In health, this gradual modernization process is aimed in the long term at achieving a sectoral organization that ensures complete coverage of the entire population on the basis of common rules of the game which stimulate efficiency and equity for all institutions, both public and private; a new financing arrangement that makes it possible to define risk-related payments; and a system of the free selection of service providers by users in an atmosphere of competition. In this context, a package of policy measures aimed at overcoming structural problems in the sector as part of a long-term vision is being supported by the Bank through the Sectoral Program for Health Sector Reforms (Loan 1348/OC-UR).

1.35 A key policy is the refinement of the regulatory framework for the entire Uruguayan health system, including, among other steps, the introduction of user protection measures, which is particularly important for the low income population. Another anticipated impact of the modernization policies contemplated is that the government will be in a position to improve the targeting of its spending in favor of the more vulnerable population groups. In this regard, the MSP is making progress in such efforts through fine-tuning the mechanisms for identifying and classifying recipients and recovering costs, including pilot tests of the computer systems and management systems that will be used.

1.36 In the area of social security, the reforms are making the system more progressive. The reform of the contributory pensions system introduced in 1996 has made great strides in this direction. As mentioned previously, the levels of participation in the new system by those members for whom entering the new system was optional have exceeded even the most optimistic projections. Thus the new system is crucial in the logic of gradually establishing a more direct relationship between contributions paid in during one's working life and pensions collected thereafter, so as to contribute to the gradual reduction of the pressures on public spending generated by the deficit of the Uruguay's overall contributory pensions system, which made its consolidation necessary.

1.37 Finally, regarding the programs and assistance for contributing and noncontributing beneficiaries, the BPS has been making progress in terms of establishing stricter rules on the eligibility of recipients and on the granting of extensions for social benefits, to which should be added the introduction of mechanisms aimed at increasing employer and employee participation in their financing and improved targeting. One of the difficulties facing the BPS in the consolidation of the various contributory and non-contributory payments it administers was the multiplicity of information bases on the beneficiaries of the various programs, which, combined with the fact that they were not computerized and there are no mechanisms for the identification, monitoring, and control of beneficiaries, contributed to the general inefficiency of the system. For this reason, since 1997 the BPS has been implementing a plan to re-engineer the administration and monitoring of all its payments. This re-engineering plan has been designed in stages, with its implementation beginning in the area of payments to active workers and extending to family allowances in 2001 and to old age and disability pensions in 2002.

1.38 Computerization of the various information bases and their unification into a common structure has made it possible to check, identify, and control the eligibility of the beneficiaries of the various payments, resulting, for example, in a 20% reduction in the number of recipients of family allowances. The next step will be to establish the methodological and operational foundations for improved control, including field supervision of beneficiaries with a view to confirming the consistency between the cadastral information available in the BPS and the declarations on the current circumstances of said beneficiaries. The implementation of this plan of action for the monitoring and control of the recipients of family allowances and old-age and disability pensions is part of the modernizing efforts to be pursued by the BPS. Based on a classification of the types of beneficiaries of the various payments, the plan will define the monitoring and control methodology and strategies (such as the frequency and the instrument) best suited to the various groups, so as to (i) determine the real continuation of the entitlement to the payment; and (ii) eliminate the issuance of unjustified payments, thereby enhancing the efficiency of these resource flows.

5. Priority programs in the education, health, and social security systems

1.39 The current climate of severe budgetary restrictions requires the efficient prioritization of resources to ensure sustainability in the delivery of redistributive social payments, thereby preventing disruption of the social fabric of Uruguayan society and preserving important components relating to the development of human and social capital in the country.

1.40 To this end, this section summarizes a set of investments in education, health, and social security which the Uruguayan authorities believe can contribute to meeting these objectives and must therefore be given priority in sectoral spending. Principally, the programs were prioritized in accordance with their concentration on the neediest population groups and the most vulnerable such as children, mothers, the unemployed, and the elderly. In addition, some special cases such as certain health programs were selected by virtue of their nature as public goods with positive externalities for the population as a whole. An additional program selection criterion was the strategic nature of certain interventions in the ongoing modernization efforts, such as the secondary education program, the health sector modernization program, and the social security reform. Additional details on the objectives of the prioritized programs, their coverage in terms of beneficiaries and/or payments, and the selection criteria are available in the technical files.

1.41 In general terms, the education sector has prioritized its spending on those lines of action that benefit the neediest population groups in the area of primary education and which, in turn, make it possible to continue the transformation of secondary education. The targeted programs include: (i) the school food program designed to provide various modalities for food services to schools, particularly those located in poorer areas; (ii) schools in a critical sociocultural context, which offer preschool and primary education and have high failure rates; (iii) full-time schools which provide preschool and primary education and are intended to offer greater coverage and higher quality service to boys and girls age 4 to 11 living in unfavorable socioeconomic circumstances. This intervention assumes a longer school day, improved school infrastructure and equipment, teacher training, and the purchase and distribution of educational materials. Another priority identified is the afore-mentioned MEMFOD, the objective of which is to universalize the first cycle of secondary education and transform the second cycle. The latter program meets the criterion of avoiding reversals in modernization policy actions.

1.42 In health, expenditure has been prioritized in the areas of operation and maintenance of health facilities, specifically as regards primary and secondary care, including spending under the Family Medicine Program as it most directly targets mothers and children in the poorest population groups. Another important priority for the sector is represented by a subgroup of public health programs such as the Expanded Immunization Program (PAI), the Reagents Program for Epidemiological Control, and the Aedes Campaign to prevent dengue fever, based on a criterion of being a public good involving interventions with positive externalities for the population as a whole. In addition, and consistent with the criteria of avoiding delays in carrying out the modernization policy actions, priority has been accorded to spending on technically strengthening the afore-mentioned Sectoral Reform Program for the Health Sector also supported by the Bank.

1.43 With respect to social security, priority has been accorded a group of targeted programs such as family allowances, unemployment insurance, and old-age and disability pensions. Here, the most important common characteristic is income transfer, through monetary subsidies, to some of the most vulnerable population groups that are most severely affected in the prevailing adverse macroeconomic climate: low-income families and/or single-parent families headed by women with children aged 0 to 16, low-income adults without access to the contributory pensions system and the unemployed. Also included as a priority are the transfers of contributions to individual savings accounts by participants in the new pension system, because, while it represents a smaller percentage within the total spending on contributory pensions, it is important to consolidate its development and it is also a modernization reform supported by the Bank.

C. Bank strategy

1.44 The key objective of the Bank Strategy in Uruguay is to support the government's development programs and policies for the five year period 2000-2004 that are aimed at achieving sustained growth of GDP and greater social equity in a context of macroeconomic stability. In more operational terms, the Bank Strategy is concentrated on: (i) supporting initiatives that enhance the competitiveness of national production in the region and internationally and that promote private investment on the basis of production sustained owing to its comparative advantages and the incorporation of modern technology, with a view to creating sound competitive commissions that permit greater penetration into regional and international markets; (ii) support continuation of the process of transforming and modernizing the state to reduce its weight in the economy; increase its efficiency; rationalize and target its intervention; and decrease its impact on the costs of national production of goods and services; and (iii) support efforts to improve social well-being and increase equity, while incorporating the most vulnerable groups in the development process and a better quality of life.

1.45 Accordingly, and in the prevailing adverse international economic circumstances affecting Uruguay, this Social Protection and Sustainability Program is part of the strategic dimension of improving social well-being and enhancing equity which guides the Bank's activities in Uruguay. Protection of spending on education, health, and social security contributes in general terms to continuing to ensure the greatest potential redistributive impact of social public spending. More specifically, the budgetary protection of Priority Social Programs (PSPs), based principally on a criterion of targeting the neediest population groups, can also help mitigate the effects of recent adjustments in public spending on those with the greatest need for just such support in unfavorable economic conditions. In addition, strengthening the modernization policies now being implemented in education, health, and social security can contribute to enhanced efficiency in the management of these important social sectors and equity in access to the social benefits they provide.

D. Experiences and lessons learned

1.46 The Bank has gained significant experience with special programs in countries such as Argentina, Brazil, Colombia, and Peru, and the lessons learned in them will be critical to the proper conduct of this operation in Uruguay (Document of the Bank's Office of Evaluation and Oversight, RE-251). Ranked by their order of importance, these lessons relate to the recommendations to: (i) maintain conditionality focused on the protection of social spending benefiting the poor, owing to its mitigating social impact during the crisis as was the case with the Reform and Social Protection Plan in Brazil (Loan 1774/OC-BR); (ii) analyze whether it is possible to measure the most direct impact of such special Bank programs; (iii) assume a lead role in the country dialogue on agreed policy actions, rather than merely following IMF and WB conditionality; and (iv) reduce the number of contractual conditions, especially those relating to process issues (terms of reference, studies, and plans). In addition, it is advisable to bear in mind that the insertion of this type of program in the context of joint international and multilateral support (IMF, WB, and IDB) helps to calm adverse signals to the markets produced by international financial contagion, a situation of considerable relevance given current economic realities in Uruguay.

1.47 In this regard, it should be noted that the principal component of this operation is the budgetary protection of the PSPs in education, health, and social security. Moreover, the operation has been designed in the effort to achieve balance between following through a process in the operation's short term, and the need to evaluate its more direct performance. To complement this approach, it is hoped to establish the greatest possible coordination with the IMF and WB, while the Bank assumes clear leadership in the social protection and sustainability in the afore-mentioned sectors.

1.48 As noted earlier, this program takes place in the context of the Stand-by Agreement between Uruguay and the IMF aimed at restoring basic macroeconomic equilibria, and at this level there will be close coordination with the IMF to guarantee monitoring in a macroeconomic climate consistent with that agreement. As regards coordination with the WB, it bears noting that that organization is preparing a Sector Adjustment Loan (SAL) in an amount estimated at US$250 million, which would involve social protection in the areas of preschool and primary education, early childhood and family, the accompaniment of more structural reforms in the area of social security, particularly in relation to unemployment insurance, and in the housing area, with the process of reforming the Uruguay Mortgage Bank (BHU). In the case of unemployment insurance, for example, these more structural reforms would be aimed at increasing coverage and improving the efficiency of unemployment insurance through legal changes reducing automatic renewals and establishing a decreasing structure for the subsidy granted, alongside the expansion of training programs for the unemployed poor in the informal sector.

1.49 In the dialogue with the Uruguayan authorities, as well as with WB representatives in Uruguay, it was agreed that the policy actions contemplated in the IDB operation fully complement the actions identified within the framework of the afore-mentioned loan being prepared by the WB. For this reason, and has been the case throughout the preparation, in the execution phase an effort will be made to maintain close coordination with the team from that international organization with a view to achieving the maximum possible synergistic effects for Uruguay from the joint action of both operations. This will be facilitated in a context in which both operations have similar approval and execution timetables, and share the emphasis on the budgetary protection of three PSPs (School Food Program, Family Allowances, and Full-time Schools) out of the total of eight programs protected by the World Bank and a total of 14 PSPs benefiting from budgetary protection under this IDB program.

E. Program rationale and justification

1.50 Given the current economic situation in Uruguay, supporting the country in the context of the joint financial assistance decided by the international community and the major multilateral credit and development agencies is amply justified. The further rationale of this joint effort is to support a country that has been implementing a range of modernization policies which continue to enhance the competitiveness of the Uruguayan economy and improve the living conditions of all its inhabitants and which, in the difficult international scenario, has had to take hard fiscal adjustment measures in order to restore its basic macroeconomic equilibria and increase its chances of emerging from this crisis of external origin and return to the path of sustained growth.

1.51 Moreover, this support from the Bank makes use of an instrument specially designed for these circumstances, the aim of which is to mitigate the effects of the fiscal adjustment on the poorest sectors of the population (document on emergency lending guidelines, GN-2031-10). This is achieved by means of concrete interventions in the education, health, and social security sectors which have the greatest redistributive impact on social spending, intended to provide budgetary protection for the PSPs with the greatest focus on the needy population groups while strengthening and supporting a package of modernization measures currently being implemented in these social sectors to prevent their reversal. Along the line of these modernizations, budgetary protection is also extended to the most important social investment currently supported by the Bank in Uruguay, represented by the MEMFOD, which, while not principally targeted, is an important tool in the educational policies aimed at definitively curbing school abandonment and providing a bridge between students and the world of work.

1.52 Finally, it should be stressed that a major effort has been made in preparing this operation, especially as regards the logic over time of the policy actions agreed, so that in the second tranche there will be a number of intermediate and final products making it possible to assess the more direct performance of this program by means of concrete milestones, bearing in mind at all times that it is an operation with a maximum term of 12 months for its execution. Furthermore, it has been agreed with the Uruguayan authorities that this program will be accompanied by bimonthly monitoring reports that can provide early warning about possible difficulties and slippages, making it possible to ensure the timely compliance with the undertakings contemplated in the program matrix of policy measures.

II. THE PROGRAM

A. Objectives

2.1 The program objective will be to support the Government of Uruguay in providing budgetary protection for PSPs in education, health, and social security, while simultaneously ensuring the sustainability of modernization efforts now in progress in these social sectors, so as to avoid having the effects of the ongoing economic crisis impact on the poorer population groups, prevent deterioration in the country's social indicators, and causing reversals in the ongoing modernization efforts aimed at enhancing the efficiency and equity of access to these social benefits by the needy groups.

2.2 The timeframe used in constructing the Program's Matrix of Policy Measures depends on completion during the first tranche of actions in the purview of the Executive Branch, such as Decrees, Resolutions, or Circulars for general application, in order to implement the budgetary protection of the PSPs and to strengthen the advances made in modernizing these social sectors. The second tranche depends on compliance with budget execution targets for fiscal years 2002 and 2003 in the area of social protection, as well as concrete milestones for assessing the strengthening of the progress made in modernizing the social sustainability area.

B. Areas of action

2.3 The program would include three action areas (see Annex II-1 and Annex Table II-1): (i) monitoring agreements with the International Monetary Fund (IMF) aimed at maintaining a stable macroeconomic framework; (ii) budgetary protection of the PSPs in the areas of education, health, and social security; and (iii) sustainability of the progress made in modernizing education, health, and social security.

2.4 **Monitoring agreements with the IMF aimed at maintaining a stable macroeconomic framework**: The last three years of recession affecting the Uruguayan economy, largely of international origin, combined with the recent financial contagion effect which is also internationally triggered, has had an impact on Uruguay's ability to achieve some basic macroeconomic equilibria. For this reason, and in conformity with the logic of this operation, it is necessary to monitor the recent Stand-by Agreement between the Uruguayan authorities and the IMF for the 2002-2004 period, the chief aim of which is to restore macroeconomic equilibrium and lay the groundwork for revitalizing the Uruguayan economy.

2.5 In this policy area, for the *first and second tranches* it is planned to submit evidence satisfactory to the Bank of the maintenance of consistency with the macroeconomic environment agreed with the IMF.

2.6 The impact of such monitoring is expected to be contributing to compliance with the macroeconomic objectives that will give rise to an environment conducive to a reactivation of production and a rebound in employment levels, in the context of financial assistance to Uruguay granted by the international community, multilateral credit agencies, and development institutions.

2.7 **Budgetary protection of the PSPs in the areas of education, health, and social security**: As noted in the frame of reference for this operation, the overall level of public spending, including social spending, has been cut back significantly as a result of the fiscal adjustment needed to restore Uruguay's basic macroeconomic equilibria and establish a sound basis for the sustained growth of its economy (Fiscal Responsibility Law of February 2002 and Fiscal Stability Law approved in May 2002). Moreover, in view of the downturn in economic activity levels in Uruguay in the first quarter of 2002 and the projections for the regional economic climate, it is expected that a further adjustment in public spending will be made in the framework of the Budget Closure Law shortly to be submitted to the Legislative Branch.

2.8 Under these circumstances, it was agreed in the dialogue with the authorities to provide budgetary protection for the nonwage expenditure of PSPs for fiscal years 2002 and 2003 on the basis of the recently adjusted 2002 budget and in Uruguayan pesos at constant value.[5] In this context of agreements, the undertaking assumed by the economic authorities is that these programs will be budgetarily protected and will not be scaled back in the event that a further adjustment proves necessary.

2.9 In this policy area, the *first tranche* requires submission to the satisfaction of the Bank of evidence that the following are in force: (i) the ANEP Central Board of Directors Resolution implementing the budgetary protection of the education PSPs in accordance with the terms set forth in Annex Table II-1; (ii) the MSP Resolution implementing the budgetary protection of the health PSPs in accordance with the terms set forth in Annex Table II-1; and (iii) the BPS Resolution implementing the budgetary protection of the social security PSPs in accordance with the terms set forth in Annex Table II-1.

2.10 The *second tranche* requires submission to the satisfaction of the Bank of evidence to the effect that: (i) accrued budget execution in 2002, in terms of the expenditure commitments, for all PSPs in education, health, and social security amounts to at

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[5] Budgetary protection applies to nonwage expenditure because the wage component has less downward flexibility as a result of legal protections applicable to the common roster of civil servants in public institutions.

least 90% of the amount agreed with the Bank and reflected in the "2002 Protected Budget" in Annex Table II-1; and (ii) as of the date of submission of the request for disbursement, accrued budget execution for all the PSPs in education, health, and social security has amounted to at least: (a) 15% of the total amount agreed with the Bank and reflected in the "2003 Protected Budget" in Annex Table II-1 for the first quarter of 2003, if said request is submitted within no more than 30 calendar days following the end of that quarter; or (b) a percentage proportional to 90% of the total amount agreed with the Bank and reflected in the "2003 Protected Budget" in Annex Table II-1 if the request is submitted after that date.

2.11 The anticipated impact of budgetary protection for the PSPs in the areas of education, health, and social security is to contribute to mitigating the negative impact on the poorest population groups of possible further fiscal adjustments, by maintaining in 2002 and 2003 the budgetary protection of PSP expenditure. For reference purposes, the table which follows sets forth the relative structure of the budgetary protection of PSPs in education, health, and social security in order to note the relative importance in total budget amounts of the ANEP, the MSP, and the BPS, respectively, both including wages and with the wage component excluded. This table also shows the relative importance of the total amount of the budgetary protection of the PSPs in relation to total social public spending, both including wages and with the wage component excluded, as well as to total consolidated public spending, on the same basis as the previous comparison.

Table II-1: Relative importance of the budgetary protection of PSPs	
Education PSPs	
Percentage of the ANEP Budget	8.6%
Percentage of the ANEP Budget, excluding wages and salaries	43.5%
Health PSPs	
Percentage of the MSP Budget	32.5%
Percentage of the MSP Budget, excluding wages and salaries	51.1%
Social Security PSPs	
Percentage of the BPS Budget	17.1%
Percentage of the BPS Budget, excluding wages and salaries	17.5%
All PSPs	
Percentage of the Social Budget	14.3%
Percentage of the Social Budget, excluding wages and salaries	17.5%
Percentage of the Public Budget	10.0%
Percentage of the Public Budget, excluding wages and salaries	12.2%

Source: Table I-2 and Annex Table II-1.

2.12 A key factor in successfully achieving this impact in the area of PSP budgetary protection, and in the area discussed below regarding the sustainability of the progress made with modernization is the political will of the Uruguayan authorities to fulfill the commitments entered into under this program until budget year 2004, as reflected in the Policy Letter referred to below in the chapter of this document devoted to execution and evaluation.

2.13 **Sustainability of the progress made in modernizing education, health, and social security**: In the context of an unfavorable economic scenario there is a tendency to postpone important modernizations in the social sectors, for which reason this action area in the program is aimed at sustaining modernization efforts in progress in the education, health, and social security sectors

2.14 The *first tranche* requires submission to the satisfaction of the Bank of evidence that the following are in force: (i) the ANEP Central Board of Directors Resolution authorizing a National Height-for-weight Census to begin by September 2002 in all schools throughout Uruguay with a view to improving the targeting of the PAE; (ii) the ANEP Central Board of Directors Resolution providing that cooperation between the Secondary School Student Parents Associations (APALs) and the Development Commissions of technical schools must assign priority to cleanup of secondary school education centers; (iii) the Executive Branch Decree establishing new standards for the public health subsystem on the identification and classification of users, and establishing prices for the payment by private health institutions reflecting the real cost of care rendered to their beneficiaries in public health facilities; (iv) the MSP's technical proposals on instruments to protect the rights of users (pamphlet on user rights and responsibilities, procedures for filing complaints and resolving disputes) are drafted and will shortly be the subject of circulars from the Health Services Division (DSS) of the MSP; (v) the BPS Resolution implementing an action plan for the monitoring and control of beneficiaries of family allowances and old-age and disability pensions, for purposes of improving the targeting of the corresponding economic payments; and (vi) submission of the latest quarterly report of the Actuarial Economic Advisory Unit of the BPS, showing that the relationship between participant contributions to the Individual Savings System transferred by the BPS to their individual accounts and the contributions of assets from the new system transferred by them to the BPS remains above 90%.

2.15 The *second tranche* requires submission to the satisfaction of the Bank of: (i) an ANEP Evaluation Report setting forth the results of carrying out the Height census and proposals for new criteria for targeting the PAE; (ii) an ANEP Evaluation Report on progress achieved in the activities for cleanup of secondary school education centers; (iii) an Evaluation Report on pilot experiences with the computerized system for the identification and classification of users as implemented in the Hospitals of Paysandú and Minas, together with proposals for generalizing application of the system in all the public health facilities; (iv) evidence that the DSS/MSP Circulars providing operational instructions generally applicable to health facilities on the protection of user rights (pamphlet on user rights and obligations, procedures for submitting complaints and for conflict resolution) are in force; (v) a BPS Evaluation Report on the progress made with carrying out the Action Plan, in terms of improved beneficiary identification and more targeted control of family allowances and old-age and disability pensions; and (vi) the latest quarterly report of the Actuarial Economic Advisory Unit of the BPS, showing that the relationship between participant contributions to the Individual Savings System transferred by the BPS to their individual accounts and the contributions of assets from the new system transferred by them to the BPS remains above 90%.

2.16 As the anticipated impact of this policy area, it is hoped to contribute to preventing delays in the modernization policies aimed at enhancing efficiency in the management of the education, health, and social security sectors, as well as equitable access to these social benefits. This, in conjunction with the budgetary protection of PSPs, will make it possible to prevent deterioration in the situation of the poorest in terms of the benefits and payments they receive at present, as well as to avoid declines in Uruguay’s social indicators in the current critical economic conditions.

C. Cost and scale of the operation

2.17 The Social Protection and Sustainability Program will provide a total of US$500 million to the national treasury, to be financed against the Ordinary Capital resources of the Bank in its emergency loan window. Specifically because this is an emergency loan, the resources will not be contingent on the execution of any particular component, but rather on overall compliance to the satisfaction of the Bank with the policy actions defined and agreed for purposes of the Program. The scale of this operation is justified in terms of the resources involved in the policy actions headed up by the MEF to guarantee the budgetary protection of the PSPs and prevent the reversal of the sectoral modernizations, as well as in light of the financial programming of external resources planned by the economic authorities (MEF and OPP).

III. EXECUTION AND EVALUATION

A. Borrower and executing agency

3.1 The borrower will be the Eastern Republic of Uruguay, and the Ministry of Economy and Finance (MEF) will be the executing agency responsible for the program in coordination with the OPP. The ANEP, MSP, and BPS, as agencies responsible for execution of the PSPs, will be responsible for implementing the programmed actions and measures.

B. Execution and administration

3.2 The executive responsibilities and functions relating to execution of this operation will be assumed by a Program Coordination Unit (UCP) reporting to the MEF's Macroeconomic and Financial Programming Office, which, with support from the Technical Advisory on Social Policies (ATPS) of the OPP, will be the technical and administrative unit coordinating relations with the Bank. For program execution purposes and to ensure proper compliance with the agreements created under the policy action matrix, execution agreements will be subscribed between the MEF and OPP and the ANEP, MSP, and BPS, respectively. These execution agreements will cover the budgetary allocation and protection of the PSPs as well as the modernization activities in progress in the social sectors concerned, as the technical and operational responsibility of the specialized line units of the ANEP, MSP, and BPS.

3.3 The UCP-MEF will be the executive body responsible for the administration and general supervision of the program, reporting the results of its efforts directly to the Minister of Economy and Finance. Moreover, monitoring and program evaluation will be the responsibility of the ATPS-OPP, which will report the results of its activities directly to the UCP-MEF coordinator.

3.4 For purposes of program execution and coordination with the Bank, the UCP-MEF shall: (i) coordinate the signature of technical agreements on execution and supervise the actions undertaken by sectoral institutions participating in the program, particularly as regards the implementation of agreed policy actions required for the disbursement of the two loan disbursement tranches; (ii) compile and submit to the Bank the information required for it to authorize disbursement of each tranche, by collecting and verifying the background information and documentation required to prove compliance with the policy actions agreed in the loan contract; (iii) act as the government's principal technical interlocutor vis-à-vis the Bank; (iv) administer the fast disbursement financial resources in accordance with the Bank's standards for sector loans; and (v) prepare the reports required by the Bank. The ATPS-OPP shall be responsible for: (i) monitoring progress under the program agreed with the Bank in order to facilitate the completion of the policy actions required for the second tranche, by means of bimonthly monitoring reports; and (ii) submit to the Bank, through the executing agency, a final program evaluation report.

3.5 Under the execution agreements to be subscribed with the sectoral agencies responsible for the PSPs, the UCP-MEF will have a simple management structure consisting of a general coordinator trained as an economist and experienced in the management of projects financed with support from international organizations, a technical coordinator with experience working in the social sectors, and an administrative coordinator experienced in the disbursement and operational procedures of international organizations.

3.6 To ensure compliance with each and every one of the policy actions agreed under the loan contract, the execution agreements will establish terms and deadlines that assure the UCP-MEF of timely processing at the Bank of the disbursement authorizations. By virtue of the foregoing, the loan contract, the matrix of policy actions, and the bimonthly monitoring reports will be deemed integral parts of said execution agreements between the MEF and OPP and the ANEP, MSP, and BPS.

3.7 The specialized line units of the ANEP (National Directorate of Public Education), the MSP (Subsecretariat of Health), and the BPS (General Management) will have operational responsibility for compliance with the contractual undertakings under the execution agreements signed. For these purposes, each sectoral agency shall designate, within the framework of the execution agreements, a technical coordinator who shall assume operational responsibility for carrying out the policy actions corresponding to his or her respective area of activity and ensure the timely delivery in due form of the documentation to be processed by the Bank for purposes of authorizing disbursements.

C. Execution period, amounts, and disbursement timetable

3.8 The maximum execution period for the Bank's emergency loans is 18 months, but in this particular case it is planned to disburse the resources over a period of about 12 months, with a first tranch of US$340 million and a second tranch of US$160 million. Depending upon projected compliance with the agreed policy actions, it is planned to disburse the first tranche in the third quarter of 2002 and to disburse the second tranche in the first quarter of 2003.

D. Conditions for processing disbursements

3.9 Disbursement of the resources corresponding to each tranche will be conditioned on compliance with the policy actions agreed for the tranche concerned, specified in Chapter II and in Annex II-1 to this loan document.

3.10 For the specific case of the first disbursement, additional prior conditions will be: (i) the opening of a special account for managing the program financing resources;

(ii) effective operation of the UCP under the MEF, with the staff previously agreed upon with the Bank for the proper conduct of the program; and (iii) signature of the project execution agreements between the MEF and the OPP and the sectoral agencies (ANEP, MSP, and BPS).

3.11 The borrower, through the executing agency, will be responsible for maintaining the accounting and financial records on the use of the financing resources and for preparing and submitting disbursement requests, and shall guarantee that said documentation will be available for possible inspections by the Bank and/or external auditors. The borrower shall maintain the special account intended for managing the financing under the loan and shall submit the information on this account to the Bank before the first disbursement is made.

3.12 The project team shall evaluate the information submitted by Uruguay for compliance with the agreed policy actions and shall prepare the corresponding reports for the Administration and Board of Executive Directors of the Bank with a view to requesting authorization of the disbursements in accordance with the policy in force.

E. Program monitoring and evaluation

3.13 Considering the narrow timeframe for execution of this program established by its planned financial programming, agreement has been reached with the executing agency, as a special exception, for its monitoring through bimonthly monitoring reports that will make it possible to ensure timely compliance with the related policy actions, especially for authorization of the second disbursement tranche. For these reasons, there will also be a clear listing of the budget headings subject to monitoring, which will make it possible to corroborate precisely the expenditure under each of the PSPs. In this way, the monitoring reports will present the progress achieved by the executing agency using as a basis key progress milestones agreed with the Bank for each PSP and modernization activity in progress, milestones that will serve as early warning signals for identifying any lags and taking corrective actions aimed at ensuring compliance with all the agreed policy actions.

3.14 For the final evaluation of the program, agreement has been reached with the Uruguayan authorities on a set of indicators to measure the progress achieved in the actions and measures called for under the program. To this end, a baseline has been established for coverage in terms of beneficiaries and/or payments for the following PSPs: (i) education: school food program, program for schools in critical sociocultural circumstances, program for full-time schools; (ii) health: expanded immunization program and program for primary and secondary care in public health facilities; and (iii) social security: program on family allowances and old-age and disability pensions. For each of these programs, a target has been set for December 2003 which is basically intended to maintain or broaden the coverage recorded as of December 2001. Annex III-1 sets forth the baseline data and targets for each of the performance indicators established.

3.15 Moreover, and considering the special nature of and specific circumstances surrounding this emergency operation, agreement has also been reached on a series of impact indicators that will make it possible to measure program effectiveness in terms of mitigating the effects of the crisis on the poor and vulnerable, by protecting the financing of social programs benefiting the poor and preventing reversals in policy reforms, so as to avoid any deterioration in Uruguay's social indicators. These impact indicators are also presented in Annex III-1 for the program as a whole, using a baseline at December 2001 and targets for 2004 within the framework of a set of assumptions for that time horizon which extends beyond the execution period of this operation.

3.16 In accordance with the policies and procedures in force, the Uruguayan authorities were consulted as to their readiness to conduct an ex post evaluation of the program. The authorities indicated their desire not to conduct such an evaluation, but undertook to maintain the necessary information on the performance and impact indicators referred to in Annex III-1 and make it available for the Bank in the event that, should it be deemed necessary, it can subsequently conduct an ex post program evaluation. This said, it is recommended that the final evaluation of this operation include an analysis of the situation "with and without a program," that is, an analysis of what the impact on the poorest population groups would have been had there been no protection of the spending on PSPs and had no further impetus been placed on modernization efforts in education, health, and social security.

F. Policy letter

3.17 The Bank agreed with the borrower on the policies delineated in the Policy Letter attached as Annex III-2 to this document. The letter presents a summary of the economic and social policies implemented by the Uruguayan government at the time specific policies actions were formulated to ensure the budgetary protection of the PSPs in education, health, and social security, together with the modernization policies introduced in those sectors to improve their managerial efficiency and equity of access to the benefits they provide.

3.18 Considering that the planned disbursement schedule for the program only makes it possible to maintain effective protection of the PSPs until the first quarter of 2003, when it is expected to make the second and final disbursement, the Uruguayan authorities have also undertaken, in the context of the agreements and proposals created in the Policy Letter, to maintain the protection of the PSPs at at least the amounts agreed with the Bank, as well as the support for modernization efforts, at least until December 2004.

G. External audit

3.19 The Bank reserves the right to request from the borrower financial reports on the use of the financing resources prepared by independent auditors approved in advance by the Bank.

H. Inspection and supervision

3.20 The Bank shall establish such inspection procedures as it deems necessary for purposes of satisfactory execution of this special loan. To this end, the borrower shall fully cooperate by providing all necessary assistance and information.

IV. VIABILITY AND RISKS

A. Viability

4.1 In response to the serious economic crisis being experienced by Uruguay, which is largely international in origin and threatens to have negative consequences for the poorest population groups and trigger a major deterioration in social indicators, the Government of Uruguay has the firm political will to carry out a Social Protection and Sustainability Program expressed through all its agreed policy actions, a political will which speaks for the viability of this operation and is the subject of undertakings not only by the authorities of the MEF and OPP, but is also supported and assumed by the sectoral authorities represented by the ANEP, MSP, and BPS.

4.2 Specifically, this undertaking by the economic authorities and those in the social sectors of education, health, and social security in Uruguay takes the form of the agreements reached on the program execution and administration mechanism which imports institutional viability to it. Accordingly, agreement has been reached on a program execution design under which the managerial, executive, and administrative responsibilities (MEF and OPP), together with the technical and operational responsibilities (ANEP, MSP, and BPS) are defined in their respective areas of jurisdiction, and an incentive is also created so that the agencies responsible for oversight of the financial programming of external resources and budget programming of public spending (MEF), together with the institution responsible for monitoring budget execution (OPP), supervise compliance with the policy actions on the part of those with technical and operational responsibility for carrying them out (ANEP, MSP, and BPS) given the interest in ensuring that disbursements are effectively made. Furthermore, a virtuous nexus is created between the agencies responsible for managing budget resources in the country and the sectoral managers accountable for executing social protection and sustainability actions, with a view to ensuring adequate funding availability under the budget and timely financial programming of the resources making the program viable. Furthermore, and in cognizance of the magnitude of the challenges for implementing such actions, the ANEP, MSP, and BPS authorities have incorporated into the technical and operational structure for the program their line units participating in the direct execution of the policy actions, so as to ensure their effective involvement as well as their commitment to the success of the operation.

4.3 From the standpoint of the program’s political and economic viability, it bears noting that this operation is part and parcel of a comprehensive assistance package from the international community, multilateral credit organizations, and development institutions, which have decided to support a country that has been adopting serious policies to promote the competitiveness of its economy, economic reactivation, and social progress on the part of the neediest, in an economically complex external regional context. As indicated earlier, in June 2002 the IMF approved a US$1.5 billion increase in its Stand-By Agreement with Uruguay, which constitutes support for the government's economic management and lays the groundwork for the effective strengthening of the Uruguayan financial system, thereby contributing to warding off the possibilities of speculative contagion. Yet another positive signal is represented by the recent decision by Uruguay's economic authorities to introduce a freely floating exchange rate so as to avoid speculative attacks on the currency and capital flight abroad.

B. Environmental and social feasibility

4.4 In view of the special characteristics of the program which provides budgetary support for expenditure on existing social initiatives, there are not expected to be any direct environmental impacts, and consequently no new actions which might require an assessment of environmental impact. In addition, the actions incorporated with a view to preventing any reversal in the modernization efforts in the education, health, and social security sectors are the outgrowth of programs already in compliance with the environmental policies of Uruguay and the Bank, and hence require no additional analysis.

4.5 Although it does protect social spending and strengthens modernization efforts in the social sectors, in accordance with the operational guidelines for such special programs (GN-2031-10), this operation does not qualify as poverty-targeted or social equity-enhancing.

4.6 From the gender standpoint, it bears noting that more women than men are users of the health system, given the importance of maternal care among all the budgetarily protected services.[6] Likewise, low-income widows without children or relatives and without access to a formal social protection network represent another very large group of beneficiaries of these programs. Female heads-of-household, whether or not employed, make up another sizable beneficiary group. Finally, even though there are no differences in access to education by boys and girls, it is anticipated that the budgetary protection of education PSPs and continuity in the modernization efforts in this sector will contribute to reducing, in the medium or long term, the social and economic differences between the poor and the non-poor which result from differences in access to education for these two groups.

C. Benefits

4.7 The benefits of the program relate directly to its objectives, which are aimed at supporting the government's efforts to conserve the long-standing tradition of social homogeneity in Uruguay and keep the effects of the financial crisis being experienced by the country from principally affecting the poorest and most

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[6] In the public network, 50% of hospital discharges correspond to normal births (36%) and to complications of pregnancy, birth, and the immediate post-birth period (14%).

vulnerable population groups. To this end, the program, within the framework of Uruguay's agreements with the IMF aimed at restoring a stable macroeconomic framework, will apply clear targeting criteria to protect PSPs in the education, health, and social security sectors. Moreover, the set of actions in support of the program in the area of social policies will mean not just avoiding reversals that could be negative, but also taking major strides to achieve better targeting and enhanced efficiency in the management of the social services provided to the population.

4.8 More concretely, the program contributes to a clarification of social priorities that are budgetarily protected from possible future adjustments in public spending. Accordingly it manages to maintain the redistributive potential of social spending through the targeting of public resources at the most vulnerable population groups, maintaining the coverages of the PSPs in terms of beneficiaries and payments in order to mitigate the effects of the economic crisis on the poorest and preventing deterioration in Uruguay's social indicators in the medium and long term. For this reason and in relative terms, the majority of the budgetary protection is for the health PSPs (51.1%) which budgetarily protect the operating costs for primary and secondary care in maternal and child health, then in education PSPs (43.5%) in school food programs and primary education programs targeting poor children in needy neighborhoods, and finally, social security PSPs (17.5%) to provide budgetary protection for spending aimed at the children of poor families, the unemployed, and vulnerable seniors.

D. Risks

4.9 There is a risk that the financial crisis will flourish anew and generate greater pressures to adjust the budget, which could prompt even greater cutbacks in public spending. This situation might not only mean further budgetary reallocations in each of the social sectors as well as additional cuts in other non-targeted social programs, but also force cuts in the protected PSPs, which would ultimately impact the program objectives both in terms of the protection sought for the most vulnerable population groups, and in terms of the impossibility of supporting Uruguay's international reserves position should it not be possible to disburse resources from the second tranche in a timely manner. This risk would be mitigated in that total budgetary protection amounts to 10% of consolidated public expenditure, a proportion which suggests that it is reasonable to maintain budgetary protection in future if the Government of Uruguay effectively prioritizes social spending. It is further mitigated in the context of the government's new agreements with the IMF and the international financial community, which seek on the one hand to generate the conditions required for the country to return to the path of sustained economic growth, and on the other hand to protect the economy from further contagion produced by the turbulent regional economic climate. For its part, the Bank will closely monitor economic events in Uruguay and the progress made in complying with the agreements reached in the framework of this operation, using for this purpose the monitoring reports agreed with the executing agency which record bimonthly progress milestones, thereby making it possible to maintain a flexible and timely dialogue on program execution status.

MATRIX OF POLICY MEASURES
SOCIAL PROTECTION AND SUSTAINABILITY PROGRAM (UR-0151)

PROBLEM	PROGRAM MEASURE	IMPACT	FIRST TRANCHE	SECOND TRANCHE
MONITORING IMPLEMENTATION OF IMF AGREEMENTS				
The economic recession in Uruguay over the past three years, due to the international situation, in conjunction with financial contagion—also of international origin—has affected achievement of some of the basic macroeconomic equilibria in the country.	Monitor implementation of the Stand-by Agreement entered into by the country and the IMF for the period 2002-2004, the primary purpose of which is to restore macroeconomic equilibria and lay the foundation for reactivation of the Uruguayan economy.	Contribute to achieving the macroeconomic goals, creating a climate conducive to reactivating production, recovery of employment levels, and improving the situation for the very poor.	The macroeconomic framework agreed upon with the IMF is maintained.	The macroeconomic framework agreed upon with the IMF is maintained.
SOCIAL PROTECTION				
The total spending level, including social spending, may suffer major cutbacks as a result of the fiscal adjustment and have an adverse impact on the poorest segments of the population.	Protect non-salary budget allocations for priority social programs in education, health, and social security, selected mainly based on their targeting of the neediest segments of the population.	Help mitigate the adverse impact of any new fiscal adjustments on low-income groups by maintaining protection for the priority social programs that are part of the Uruguayan social protection system in the 2002 and 2003 budgets.	The resolution by the central board of directors of ANEP to protect the budget for the priority social programs in education has been implemented, in the terms set forth in Table II-1. The resolution by the MSP to protect the budget for the priority social programs in health has been implemented, in the terms set forth in Table II-1. The resolution by the BPS to protect the budget for the priority social programs in social security has been implemented, in the terms set forth in Table II-1.	The actual budget executed in 2002 for all priority social programs in education, health, and social security must be at least 90% of the amount agreed upon with the Bank and reflected in the "2002 Protected Budget" set forth in Table II-1. The actual budget executed for all priority social programs in education, health, and social security must be at least: (a) 15% of the total amount agreed upon with the Bank and reflected in the "2003 Protected Budget" set forth in Table II-1 for the first quarter of 2003, if the disbursement request is submitted within a period of no more than 30 days after the end of that quarter, or (b) a percentage proportionate to 90% of the total amount agreed upon with the Bank and reflected in the "2003 Protected Budget" set forth in Table II-1 if the request is submitted on a later date.

PROBLEM	PROGRAM MEASURE	IMPACT	FIRST TRANCHE	SECOND TRANCHE
SOCIAL SUSTAINABILITY				
In an adverse economic environment, policy measures for modernization of the social sectors tend to be postponed.	Maintain modernization policies being implemented in education, health, and social security.	Avoid any setbacks in the implementation of modernization policies designed to improve efficiency in social sector management and equity in access to social benefits.	The resolution by the central board of directors of ANEP has been implemented, authorizing a national height-for-weight census, to be conducted by September 2002 in every school nationwide, for the purpose of improving targeting by the PAE.	An ANEP evaluation report with the findings of the height-for-weight census and proposals for new PAE targeting criteria must be submitted to the Bank's satisfaction.
			The resolution by the central board of directors of ANEP has been implemented, establishing that the APALs and Development Committees of technical schools must assign priority to cooperating in activities to clean up lower secondary schools.	An ANEP evaluation report on the progress achieved in APAL cooperation in activities to clean up lower secondary schools must be submitted to the Bank's satisfaction.
			An Executive Decree has been implemented, establishing new standards for user identification and classification for the public health care subsystem and establishing fees to be charged to private health care institutions for the real cost of the services provided to their beneficiaries in public health care establishments.	An evaluation report on the pilot programs for the computerized user identification and classification system implemented in the Paysandú and Minas hospitals, together with a proposal on expanding use of the system to all other health care provider units must be submitted to the Bank's satisfaction.

PROBLEM	PROGRAM MEASURE	IMPACT	FIRST TRANCHE	SECOND TRANCHE
SOCIAL SUSTAINABILITY				
In an adverse economic environment, policy measures for modernization of the social sectors tend to be postponed.	Maintain modernization policies being implemented in education, health, and social security.	Avoid any setbacks in the implementation of modernization policies designed to improve efficiency in social sector management and equity in access to social benefits.	The MSP has submitted technical proposals on instruments to protect user rights (statement of user rights and obligations, procedures for submitting complaints and dispute resolution) that will eventually be distributed in MSP/DSS circulars, to the satisfaction of the Bank.	The MSP/DSS circulars in which general and operating instructions are provided for all health care institutions on protecting user rights (statement of user rights and obligations, procedures for submitting complaints and dispute resolution) have entered into force.
			A BPS resolution has been implemented whereby an action plan is carried out to monitor and oversee the family allowances and old age and disability pensions granted, in order to improve targeting of the respective payments.	A BPS evaluation report has been submitted to the satisfaction of the Bank, indicating the progress achieved in implementation of the action plan, in terms of better identifying beneficiaries and more targeted oversight of family allowances and old age and disability pensions.
			The last four-month report of the BPS Actuarial Economic Adviser has been submitted to the satisfaction of the Bank, demonstrating that the ratio of contributions by members of the individual savings system transferred by the BPS to their respective individual accounts and the contributions of the assets of the new system transferred by them to the BPS is being maintained at over 90%.	The last four-month report of the BPS Actuarial Economic Adviser has been submitted, demonstrating that the ratio of contributions by members of the individual savings system transferred by the BPS to their respective individual accounts and the contributions of the assets of the new system transferred by them to the BPS is being maintained at over 90%.

BUDGETARY PROTECTION FOR PRIORITY SOCIAL PROGRAMS (PSP) IN EDUCATION, HEALTH, AND SOCIAL SECURITY				
SECTOR/PROGRAM	**2002 PROTECTED BUDGET (Ur$)**	**US$ (*) BENCHMARK**	**2003 PROTECTED BUDGET (Ur$)**	**US$ (*) BENCHMARK**
1. EDUCATION				
1.1 School meals	70,600,000	4,152,941	70,600,000	4,152,941
1.2 Schools in a critical sociocultural situation	123,000,000	7,235,294	123,000,000	7,235,294
1.3 Full-time schools/Primary level	146,600,000	8,623,529	172,100,000	10,123,529
1.4 MEMFOD	226,810,350	13,341,785	220,010,350	12,941,785
SUBTOTAL, EDUCATION	**567,010,350**	**33,353,550**	**585,710,350**	**34,453,550**
2. HEALTH				
2.1 Expanded immunization	51,162,550	3,009,562	51,162,550	3,009,562
2.2 Epidemiological surveillance	6,000,000	352,941	6,000,000	352,941
2.3 Anti-*Aedes* campaign	5,000,000	294,118	5,000,000	294,118
2.4 APS/SEC operating costs	1,091,784,117	64,222,595	1,091,784,117	64,222,595
2.5 APS/SEC physical infrastructure maintenance	24,411,236	1,435,955	24,411,236	1,435,955
2.6 Health sector reform	11,641,389	684,788	11,641,389	684,788
SUBTOTAL, HEALTH	**1,189,999,292**	**69,999,958**	**1,189,999,292**	**69,999,958**
3. SOCIAL SECURITY				
3.1 Economic payments to low-income groups	889,737,958	52,337,527	889,737,958	52,337,527
3.2 Unemployment insurance	899,862,798	52,933,106	731,138,523	43,008,148
3.3 Old age and disability pension	1,507,589,620	88,681,742	1,420,193,120	83,540,772
3.4 Pension reform	2,767,649,000	162,802,882	2,823,001,980	166,058,940
SUBTOTAL, SOCIAL SECURITY	**6,064,839,376**	**356,755,257**	**5,864,071,581**	**344,945,387**
TOTAL, PRIORITY SOCIAL PROGRAMS	**7,821,849,018**	**460,108,766**	**7,639,781,224**	**449,398,896**

Note: * Average exchange rate in 2002 is estimated at Ur$17 to US$1

BENCHMARKS FOR PERFORMANCE AND IMPACT EVALUATION OF THE SOCIAL PROTECTION AND SUSTAINABILITY PROGRAM IN URUGUAY (UR-0151)

EXPECTED PERFORMANCE	BASELINE (December 2001)	GOAL (December 2003)
Based on the protected budget for priority social programs, coverage can be maintained or expanded in terms of beneficiaries and/or services for the following programs in education, health, and social security:		
Education:		
• School meals	180,000 students	At least equal to baseline
• Schools in a critical sociocultural situation	50,000 students	At least equal to baseline
• Full-time schools	20,000 students	At least equal to baseline
Health:		
• Expanded immunization	90% of infants under 12 months of age vaccinated with DPT	At least equal to baseline
• Primary and secondary health care in public health institutions	4,997,894 outpatient visits in ASSE health care units	At least equal to baseline
Social security:		
• Family allowances	370,000 children	At least equal to baseline
• Old age and disability pension	64,500 elderly or disabled persons	At least equal to baseline
ASSUMPTIONS FOR EXPECTED PERFORMANCE	The goal for these performance indicators assumes that by better targeting social efforts, the gains in efficiency will help assist new beneficiaries arising due to the current adverse economic circumstances. Also, it assumes that no major labor conflicts arise that could paralyze activity in the education and health sectors. A 5% margin of error is considered technically acceptable for the goal according to certain inherent variations in some of these indicators.	
EXPECTED IMPACT	**BASELINE (December 2001)**	**GOAL (December 2004)**
Based on the protected budget for priority social programs and the implementation of measures for modernization, certain indicators that reflect Uruguay's social welfare can be maintained or improved.	Infant mortality rate = 13.8 per 1,000 live births	Less than or equal to baseline
	Under-5 mortality rate = 16.5 per 1,000 live births (in 2000)	Less than or equal to baseline
	Repeater rate in public schools = 10.4%	Less than or equal to baseline
	Dropout rate in public schools = 0.6%	Less than or equal to baseline
ASSUMPTIONS FOR EXPECTED IMPACT	The goal for these impact indicators assumes that all other government activities and demographic trends in the population as a whole that might influence them in the medium and long terms remain relatively constant. A 5% margin of error is considered technically acceptable for the goal according to certain inherent variations in some of these indicators.	

URUGUAY
POLICY LETTER

SOCIAL PROTECTION AND SUSTAINABILITY PROGRAM

Montevideo, July 2002

Mr. Enrique Iglesias
President
Inter-American Development Bank
Washington, D.C.

Dear Mr. Iglesias:

The purpose of this letter is to set forth the basic information on the economy of Uruguay and the frame of reference for the Social Protection Project.

A. Economic trends and short-term measures

Uruguay has been implementing an economic policy to open up its economy to regional and international competition and, at the same time, to continue broad-based structural reforms that led to sustained growth from 1985 to 1998. During that period, the per capita annual GDP growth rate was approximately 3¼%. In 1991, the government launched its price stabilization program, which was successfully completed in the late 1990s. The inflation rate, which had reached 129% in March 1991, had dropped to 3.6% at year-end 2001, the lowest in the past 50 years. The fiscal situation has also been improving, with the lowest fiscal deficit achieved in 1998 at 0.8% of GDP.

These improvements have benefited society as a whole, as other indicators demonstrate. For instance, annual investment flows in real terms were 4.6 times higher in 1998 than in 1989. In 1999, an estimated 9.4% of Uruguayans lived below the poverty line[1] and 1.8% in extreme poverty. The percentage of the population with unmet basic needs is low; school enrollment is relatively high (81.2% of the population aged 12 to 17 in 1998); infant mortality, at 14 per 1,000 live births, is one of the lowest in the region; 100% of the population has health coverage; and access to water supply, sanitation, and electric power is almost universal. The income concentration index (Gini coefficient) was 0.44 in 1999, compared with 0.492 in 1990. Social indicators and equity in Uruguay have thus been improving.

The broad-based reforms cover such diverse areas as the retirement and pension system; primary and secondary education; reengineering of the civil service; a reduction in customs

[1] Data from the United Nations Economic Commission for Latin America and the Caribbean (ECLAC).

duties and tariffs; almost complete elimination of non-tariff and para-tariff barriers; liberalization of the power generation market; free competition in telecommunications, with the exception of basic wire telephone service; opening up ports to private operators; and unrestricted imports of natural gas.

Since 1999, the Uruguayan economy has been undergoing a recession, with a cumulative decrease in GDP of 7.5% during the period from 1999 to 2001. In 2001 and early 2002, the situation worsened due to the economic and financial crisis in Argentina, with a further drop in real GDP of 10.1% during the first quarter of 2002. In addition to the fallout from the Argentine crisis, other factors have also had an adverse impact on our economy: a deterioration in the terms of trade; devaluation of the Brazilian real in 1999; the weakness of the European currencies; and the foot-and-mouth disease epidemic. The sudden stop in voluntary financing and investment in the region and in the country has compounded the recessive impact of the above-mentioned factors and made it crucial to rapidly implement new measures.

As the country has plunged deeper into a recession, public finances have been weakened by the persistent consolidated deficits. The level of debt contracted to finance them has therefore increased. To address the situation, the government further devaluated the currency and broadened the band for the currency float in June 2001 and again in January 2002, and then allowed a free float in June 2002. It also decided to step up the pace in reforms to liberalize the markets, with a series of legislative and regulatory initiatives beginning in June 2002. We are confident that the new exchange regime, together with the reforms undertaken, will help the economy resume growth and thereby increase the income of the population and reduce the unemployment rate in the fourth quarter of 2002.

The decision to drastically reduce the disequilibrium in State accounts implies a major burden of sacrifices that the government wishes to do its utmost to mitigate. To this end, it has selected a series of high-impact basic social programs that are targeted to low-income households, with a view to preventing the poor from suffering from the necessary cutbacks in certain budget items.

The government's strategy to promote a recovery of growth with price stability was cleared by the International Monetary Fund through a Stand-by Agreement that covers the period from 1 March 2002 to 31 March 2004, for a total of US$2.25 billion, of which US$650 million has been disbursed.

B. The social situation

Unlike most of the countries in the region, Uruguay, which has a population of 3.3 million, has low levels of absolute and extreme poverty and other positive social indicators. It has a history of generous social policies and a broad range of social protection programs in place, but which only very recently have begun to adjust to the demographic and economic changes the country has undergone.

Public spending represents 31.5% of GDP, and social spending accounts for 75% of all consolidated expenditures,[2] the highest proportion in the region at 23.5% of GDP. In 2000, the greatest relative weight in social spending was for education, health and security, and social welfare.

The social policy of the Uruguay government is not limited to the series of programs selected to comprise the basic social protection system. The government is committed to implementing a broad, complex long-term social development strategy that consists of a large number of programs and activities. The stability policy and fiscal adjustment program are prerequisites for the strategy to be implemented.

C. The program

In this context, the government has sought and will continue to seek to: (i) maintain government social spending according to historic parameters, while accelerating modernization of the public sector; (ii) change the structure of social protection benefits and services, through institutional reforms and action programs, with a view to increasing the impact of social spending on income redistribution; (iii) improve the quality of social spending; and (iv) better target the programs to ensure that they reach the poorer areas of the country and poorest segments of the population.

Given the tight budgetary constraints currently in effect, social benefits need to be prioritized in order to ensure their continuity and sustainability, with a view to keeping the social fabric of Uruguayan society intact and preserving major elements of human and social capital development in the country. To this end, the government, to pursue its social policy, has requested support from the Bank to maintain operation of the series of programs assigned priority without any additional cutbacks with a view to creating a social protection system for the groups deemed most vulnerable in the population.

The programs to be protected are mainly: (i) education: the School Meal Program (PAE), the Program for Schools in Critical Sociocultural Situations and Full-time/Basic-level Schools, and the Program for Modernization of Lower Secondary Education and Teacher Training; (ii) health: the Enhanced Immunization Program, the Reagent Program for Epidemiological Surveillance, the Anti-dengue Campaign (against *Aedes aegypti* mosquitoes), operation and maintenance of installed capacity, and the Health Sector Reform Program; (iii) social security: which has three major high-impact programs—the Family Allowance Program, Unemployment Insurance, and the government-funded Old Age and Disability Pension Program—and the key structural reform, under which worker contributions are being transferred to individual accounts.

[2] In addition to central government spending, consolidated public spending by the central government includes expenditures for social security, which is administered by the BPS.

D. Sector policy

1. Education

In the past few years, Uruguay has invested decisively in improving the quality, coverage, and retention rates of the education system. At the preschool level, universal access for children aged four to five was rapidly achieved. At the primary level, coverage is also universal (96%) and almost 90% of the population completes the full six years of primary education.

The purpose of the reform launched in 1996 is to extend the total years of primary and secondary education and to better equip children from poor families, by providing meals for them, additional instruction, and support, materials, transportation, and in some cases even basic clothing. Thus, programs such as school meals, full-time schools, and system-wide computer and language instruction are at the core of the education policy, which is designed to position our children in the 21st century.

2. Health

The Uruguayan health care system covers 100% of the population, which can access the services through two subsystems: the private system, financed by contributions to social security, voluntary contributions to pre-paid health care institutions, private insurance, and direct payments by users; and the public system, mainly financed by general revenue. The public subsystem operates through the State Health Care Services Administration (ASSE), police hospitals, military hospitals, the "Universidad de la República" hospital, and BPS specialized services. The public subsystem provides health care to half of the total population, including workers in the informal sector, low-income groups without any formal social security coverage, and those who have lost their coverage or cannot afford the co-payments charged by the pre-paid health care institutions.

The public health care policy emphasizes targeting resources and outreach to low-income groups for prevention and disease control. The reform for modernization calls for organizing the sector over the long term to ensure comprehensive coverage for the entire population based on core rules that promote efficiency and equity system-wide, in both public and private institutions. Furthermore, a financing system is being considered that would establish a risk-related scale of payments and a system for users to choose their health care providers in a competitive environment. The Bank is providing support for some of these programs.

Given the current circumstances, it is key that the project to enhance the regulatory framework be maintained, the installed capacity be preserved, and future major outlays avoided through prevention and wellness programs.

3. Social security

The social security system comprises a range of programs that mostly target formal sector workers and their families. The largest one is the prepaid pension system, which was reformed in 1995 and is based on two pillars: intergenerational solidarity and individual savings accounts. It also includes a series of partially or fully government-funded programs, such as the programs family allowances, families with children, even when their parents do not belong to the formal sector, health, unemployment insurance, and retirement and disability pensions.

In this context, the reforms are designed to make the system more progressive. Reform of the prepaid pension system implemented in 1995 has made significant progress in this direction, with an enrollment rate of practically 100%. In addition, reform of the family allowance program has considerably helped targeting spending to the poorest segments of the population, thereby expanding coverage.

Lastly, the government's policy for government-funded programs and services is to continue to establish stricter rules to ensure that social benefits are given to people who genuinely need them.

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The program establishes certain budget execution goals for the 2002 and 2003 fiscal years in social protection, and concrete benchmarks for evaluation of the progress achieved in modernization and sustainability of social spending. The government is committed to protecting the expenditures detailed in the annex in both 2002 and 2003, and expects to continue to maintain the programs normally beginning in 2004. To ensure efficient service delivery, the government will seek not only to maintain but to increase the total number of social program beneficiaries.

The purpose of protecting the budget for priority social programs in education, health, and social security is to mitigate the adverse impact of overall spending cuts on the poorest segments of the population by protecting the 2002 and 2003 budgets for priority social programs that make up the nationwide social protection system. The protection is also designed to avoid any setbacks in the implementation of modernization policies designed to improve efficiency in sector management and equity in access to social benefits.

Lastly, it should be noted that the government will continue to implement, enhance, and strengthen the mechanisms established to focus attention on a specific, limited series of programs for the neediest social groups, in order to develop innovative means of ensuring social welfare.