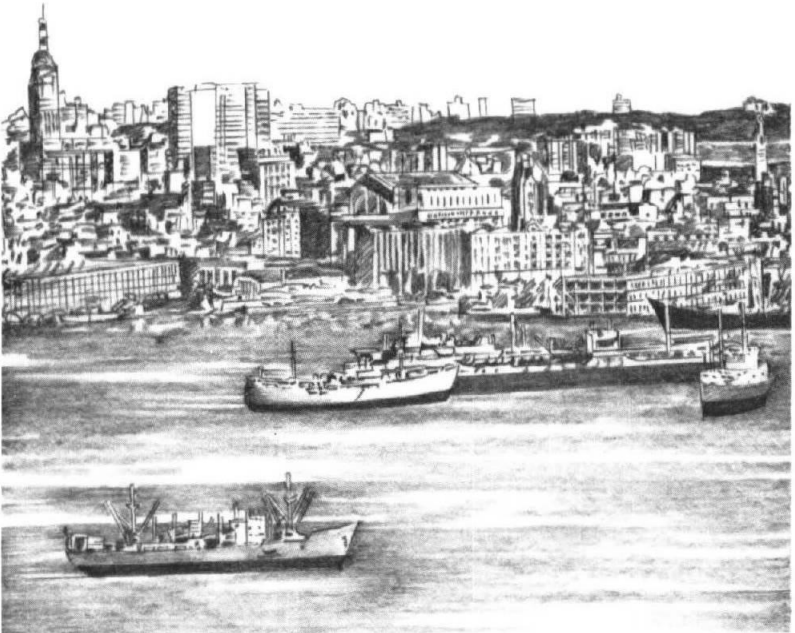


Chapter 3. The Economy



Montevideo's harbor

URUGUAY IS A WEALTHY COUNTRY by Latin American standards, although its economic development has been sluggish since the 1950s. In 1990 the country had a gross domestic product (GDP—see Glossary) of approximately US\$9.2 billion, or US\$2,970 per capita, placing it among the highest-income countries in Latin America. Uruguay's small population (just over 3 million) and low population growth (0.7 percent per year) enabled its people to maintain a reasonable standard of living during the 1980s, despite the nation's unsteady economic performance. Like many other countries in the region, Uruguay faced a large external debt and an appreciable public-sector deficit, both of which impeded the growth of the economy. Other major limitations on growth were the continued dependence on a few agricultural products and one of South America's lowest levels of foreign and domestic investment.

Uruguay's economy developed rapidly during the first three decades of the twentieth century because of expanding beef and wool exportation. Rising trade income led to the creation of an advanced welfare state in which the government redistributed wealth and protected workers. After agricultural exports leveled off in the 1950s, the government's role in the economy expanded. With agriculture stalled and manufacturing potential limited by the small size of the domestic market, the public sector became the source of most new jobs in Uruguay. The economy operated behind high tariff barriers, barring competition from abroad. An alliance between the nation's two major political parties upheld this statist model through the 1960s, but lack of GDP growth and large public-sector deficits testified to its inefficiency.

Although the military government (1973–85) enacted major economic reforms during the 1970s, it operated with high fiscal deficits and borrowed extensively to pay for those deficits. In an effort to reorient the stagnated economy toward external markets, the government eliminated price controls and slashed tariffs while providing subsidies to exporters. These reforms of the goods market produced favorable results in the short run: exports, investment, and GDP all increased significantly. When the government went further, however, by deregulating the banking sector in hopes of removing inflationary pressures, the economy became unstable. In 1981 Uruguay's economy went into recession.

One source of instability was the growing “dollarization” of the banks. When foreign-exchange regulations were canceled, United States dollars (mostly from Argentine real estate investment) flowed into Uruguay. Uruguayan banks, in turn, loaned dollars to private companies and ranchers within the country. The danger in this system was the exchange rate: when the government allowed its currency, the Uruguayan new peso (for value of the Uruguayan new peso—see Glossary), to float against the dollar in 1982, the peso value of many Uruguayan loans suddenly tripled. Thus, Uruguay faced both a recession and a domestic debt crisis in the early 1980s.

In 1986–87 the economy recovered from the recession as real GDP increased by 6.6 percent in 1986 and 4.9 percent in 1987. The renewed emphasis on exports, including several new categories of goods, resulted in a positive trade balance. Real wages, which had fallen by 50 percent in the 1970s but risen by 15 percent in the early 1980s, increased again (but only marginally), as did employment (by 4 percent). These modest improvements could not mask fundamental problems, however. Inflation averaged over 60 percent per year in the 1980s, despite efforts to reduce it. In addition, the domestic debt was largely absorbed by the public sector, but in the process Uruguay’s deficit and foreign debt became larger. Debt service alone absorbed about one-quarter of export earnings. During the last two years of the administration of Julio María Sanguinetti Cairolo (1985–90), fiscal pressures forced the government to abandon its growth-promotion strategy, and GDP did not increase. On the contrary, real GDP growth fell to 0.5 percent in 1988, 1.5 percent in 1989, and an estimated –0.4 percent in 1990.

In 1989 Sanguinetti defended his administration’s economic record in terms of what had *not* happened. In a speech to the General Assembly, he said that Uruguay’s political and economic climate remained stable in contrast to its larger neighbors (Argentina and Brazil). The nation’s economy “had not collapsed into regional hyperinflation, as was predicted; nor had the banking crisis that the government inherited destroyed the financial system; nor had the heavy external debt prevented the country from growing.” The statement was an apt summary of both the government’s cautious philosophy and of Uruguay’s limited economic progress in the late 1980s.

The Sanguinetti government could claim credit for steering a sensible course during a difficult decade for Latin American nations. The government did not, however, make much progress addressing a fundamental limitation on the economy and the leading cause of the deficit: the size of the public sector. Powerful public-sector unions made it difficult for the government to reduce public

employment. When, for example, the inefficient passenger rail service was discontinued in 1988 because of declining ridership, workers were not released but rather were transferred to other government jobs. The welfare-state model remained largely intact. By the last two years of the decade, however, economists and politicians were beginning to ask basic questions about the state's proper role in the economy.

An even more fundamental question, not addressed in the 1980s, was the economy's heavy dependence on a few livestock products, which were produced by primitive agricultural practices. Although exports could be diversified, for example, by producing not just wool but also woolen textiles and apparel, the supply of raw material depended on methods of raising sheep and cattle that had not changed significantly in two centuries. Livestock ranged over unimproved pastures whose carrying capacity was quite limited; production had actually decreased since the beginning of the twentieth century. The vulnerability of the sector was demonstrated in the late 1980s when a two-year drought (1988-89) decimated livestock herds.

Such fundamental issues were still in the background as Luis Alberto Lacalle de Herrera became president in March 1990. Lacalle indicated that his government would continue the cautious adjustment policies of its predecessor, seeking to reduce inflation and debt first and to resume growth second. Lacalle embraced privatization and drew up a bill to eliminate several state monopolies. Continued diversification of exports, including the possibility of exporting services, also appeared to hold good prospects for economic growth.

Growth and Structure of the Economy

Uruguay's recent economic history can be divided into two starkly contrasting periods. During the first, from the late 1800s until the 1950s, Uruguay achieved remarkable growth and a high standard of living. Expanding livestock exports—principally beef, mutton, and wool—accounted for this economic growth. Advanced social welfare programs, which redistributed wealth from the livestock sector to the rest of the economy, raised the standard of living for a majority of the population and contributed to social harmony. Booming livestock exports funded social programs and a state-led effort to build up new industries in Uruguay, such as domestic consumables (mainly food and beverages) and textiles. Thus, although Uruguay's economy was almost completely dependent on meat and wool exports, the strong earnings from those products helped to diversify the economy. As long as its exports

continued to expand and world prices for those exports remained high, Uruguay's economic growth was ensured.

When export earnings faltered in the 1950s, however, the fabric of Uruguay's economy began to unravel. The country entered a decades-long period of economic stagnation. Export earnings first declined when world demand fell during the Great Depression of the 1930s. Prices later recovered somewhat, but a more important limitation on Uruguay's export earnings arose: livestock production reached its limits. Without room for continued expansion of traditional exports, and without a well-developed industrial sector, it became increasingly difficult for Uruguay to uphold the social welfare model that it had adopted in more prosperous times. The memory of those times, when livestock products earned enough to make Uruguay the "Switzerland of South America," made Uruguayans reluctant to completely reshape their economy. To understand that reluctance and its consequences, it is necessary to examine Uruguay's economic history in more detail.

Colonial Period

The foundation for Uruguay's livestock-based economy was laid well before the nation achieved independence. In 1603 Spanish colonists released cattle and horses on the empty plains of what is now Uruguay, then known as the Banda Oriental (eastern side, or bank, of the Río Uruguay). The livestock thrived in Uruguay's temperate climate, grazing on the natural pastures that still cover most of the countryside. By the early 1700s, there were millions of cattle in the area. During the "leather age," which lasted for the next century and a half, Uruguay's abundant livestock attracted traders and settlers from the nearby Argentine provinces. Hides became the area's chief export. Cattle raising, which seems to have begun almost by chance, quickly took hold of Uruguay's rural economy.

The success of simple livestock-ranching techniques in Uruguay during the colonial period was to have long-term consequences. Uruguay's temperate climate, natural pastures, and abundant land (because of its small population during the colonial period) combined to favor extensive methods of raising cattle. For ranchers, these methods held two economic advantages. Both investment and labor costs were kept to a minimum because cattle ranged free, subsisted on natural grass cover, and required little care. Well after independence in 1828, even when Uruguay had become an important exporter of livestock products, these advantages continued to exert a great deal of influence on the rural sector. Despite the limitations of extensive livestock raising, including low production

levels per hectare and slow growth of stock, few ranchers ever became convinced that more intensive production techniques were worth the cost. As a result, the fundamental method of livestock production in Uruguay changed very little in over two centuries.

Postindependence Era

During the decades immediately following independence, however, political instability, not livestock production techniques, limited the development of Uruguay's rural economy. Until the mid-1800s, rival factions vied for control of the countryside, obstructing commerce and confiscating or destroying cattle and other property. Foreign investment, which was to play an important role in building up Uruguay's infrastructure, was delayed. And although the rural population was small to begin with, many settlers left the countryside in search of more peaceful surroundings. Those who remained operated cattle ranches (*estancias*) or practiced subsistence agriculture.

Rural struggles for political control thus slowed the growth of the livestock sector. By contrast, Montevideo, Uruguay's capital, where political struggles were less strident because of the city's booming trade and bustling social and cultural life, rapidly became a hub of economic activity. Montevideo was not founded until 1726, but its superb port allowed it to gain an increasing role in regional and international trade. In the 1800s, the Uruguayan capital became an important transshipment point because European importers and exporters preferred its port to that of nearby Buenos Aires (until the latter was improved in the 1870s). However, the volume of foreign traded goods passing through Montevideo had only a minimal impact on rural Uruguay. As a result, the city's development outpaced and diverged from that of the countryside. The different economic interests in the two areas helped drive a wedge between rural elites, who had amassed large landholdings and resented foreign involvement in the economy, and urban businessmen, who adopted outward-oriented attitudes and profited from trade. Later, profits from exports would become important to rural livestock producers as well, but the contrast between urban and rural economic (and political) orientations would persist.

The Export Model

After several decades of arrested development, Uruguay's economy underwent a series of important changes during the latter half of the 1800s. The consolidation of political control by the Colorado Party (Partido Colorado) and the division of the control of the departments in 1872 spelled the end of almost constant warfare

and meant that the departments of Uruguay were finally united as one nation. Internal barriers to trade were removed, and the issuance of a national currency (the peso) in 1862 favored commercial activity. Political stability also allowed increased foreign involvement in the economy and encouraged technological advances. The framework for Uruguay's primary-product export economy, which supplied food and basic inputs to Europe's dynamic industrial sector, was erected during this period.

Livestock production changed in several ways as Uruguay adjusted to the export model. First, meat-packing technology was introduced in the mid-1860s, allowing canning of meat for export. Until then, beef was preserved only in a dry, salted form (*tasajo*), which appealed to a narrow export market (principally Brazil and Cuba, where it was fed to slave laborers). Second, livestock production was diversified when sheep ranching expanded rapidly, reflecting the British textile industry's demand for imported wool. After 1870 Uruguay had more sheep than cattle, largely because of an influx of sheep ranchers from France and Britain. A third change in the livestock sector came about in the 1870s with the introduction of barbed wire. For the first time, the boundaries of large *estancias* were marked off precisely, decreasing the number of ranch hands needed to watch over herds and driving many subsistence farmers off lands on the margins of large estates. Finally, the construction of railroad lines and telegraph networks provided the infrastructure that linked rural Uruguay to the thriving port of Montevideo.

These changes in the structure of the economy paved the way for a substantial increase in export earnings while reinforcing the importance of livestock production. In 1876 Uruguay had a positive balance of trade for the first time, and its export volume more than doubled over the next decade. Exports of wool increased dramatically, matching the value of leather exports by 1884. Residents of Montevideo were said to gauge the country's prosperity by counting the stacks of cowhides and bales of wool waiting to be loaded aboard ships. After 1900 the ability to ship frozen meat to Europe and the United States transformed the beef industry, added to Uruguayan export earnings as world demand for beef grew, and raised the importance of cattle production.

The nation's rising prosperity at the turn of the twentieth century rested firmly on rural livestock production. Paradoxically, however, it was in Montevideo that the most dramatic demographic and economic effects of growth were felt. The city's population increased, mainly because several waves of immigrants arrived from Europe. Most of these immigrants came from urban areas of Italy



*Bags of wool ready for export in Montevideo
Courtesy Charles Guy Gillespie*

and Spain, so it was natural that they tended to settle in Uruguay's urban center, where jobs were available. At the same time, the city's population was increasing because of the arrival of displaced laborers from the Uruguayan countryside. Both natives and immigrants made up a growing pool of labor for Montevideo's small but dynamic industries, many of which were owned by foreigners. Using mostly artisanal techniques, the city's workshops began to supply the home market with a variety of goods, such as footwear, clothing, wine, tobacco, paper, furniture, and construction materials.

Batllism

The government's protectionist policies—in the form of tariffs on imported manufactured goods, first imposed during the late 1800s—encouraged these light industries. However, it was Uruguay's most significant political figure, José Batlle y Ordóñez (1903–07, 1911–15), who devised an overarching government strategy that took into account the growing urban population and set the tone for the nation's economic development for much of the 1900s.

Two aspects of Batlle y Ordóñez's sophisticated political program were most relevant for the long-term development of the economy. First, the social components of Batllism raised the standing of the

average laborer. The government enacted legislation that was unprecedented in Latin America: a minimum wage, a day of rest after six workdays, workmen's compensation, and old-age pensions. Second, and more significant over the long term, however, were Batlle y Ordóñez's efforts to give the state a multifaceted role in the economy. The state was to regulate the economy, perform key activities, protect laborers from unfair working conditions, and minimize the influence that foreign-owned companies would have in Uruguay (see Batlle y Ordóñez and the Modern State, ch. 1).

Under Batlle y Ordóñez's leadership, the state created or nationalized a wide range of service enterprises, officially known as autonomous entities (autonomous agencies or state enterprises; see Glossary), including an insurance company, public utilities, and mortgage banks. Later, the government became deeply involved in the production of goods, operating over twenty state enterprises, including the giant National Administration of Fuels, Alcohol, and Portland Cement (Administración Nacional de Combustibles, Alcohol, y Portland—ANCAP). By 1931 these state enterprises employed 9 percent of the nation's work force, including 16 percent of the workers in Montevideo.

Uruguay's novel economic policies bore fruit. Incomes rose on the strength of impressive export earnings. The value of exports doubled between 1900 and the onset of World War I, when beef exports, for example, reached 130,000 tons per year. Between 1926 and 1930, beef shipments continued to increase at a rapid rate, averaging 206,000 tons per year, a record that has not been equaled since then. During the same period, the Batlle y Ordóñez initiatives improved the lot of the worker, helped create a large middle class, and added to the productive capacity of the economy. The fact that all three developments—increased export earnings, improved conditions for labor, and successful state enterprises—occurred simultaneously helped Uruguayans to associate state intervention with prosperity.

The success of the export model, because of rising world demand and prices, was seen as the success of Batllism. However, as many observers have pointed out, the restructuring of the economy that occurred under Batlle y Ordóñez and his successors did not extend to the roots of that economy, the livestock sector. Because his political base did not reach beyond Montevideo into the countryside, and because he believed that market forces and property taxes would lead livestock producers to become more efficient, Batlle y Ordóñez essentially left the rural sector to its own devices. In doing so, he limited the extent to which his own bold reforms could transform the economy.

Stagnation

The precarious nature of Uruguay's primary-product export economy, so successful during the early decades of the 1900s, was gradually made clear for two distinct reasons. First, the sharp contraction of world demand for Uruguay's exports during the Great Depression showed the hazards of being at the mercy of external markets and foreign prices. Uruguay's export earnings fell by 40 percent between 1930 and 1932 as world demand contracted and importing nations adopted protectionist measures. Such a drastic decrease in earnings was only temporary, however. During World War II, prices recovered, making the export model appear viable again, if vulnerable. Still later, Uruguayan exporters were occasionally able to gain handsomely from world price increases. The most dramatic example of this phenomenon occurred during the Korean War (1950-53). Wool prices tripled temporarily as demand for cold-weather uniforms surged.

The volatility of export prices, which was itself troubling, also delayed recognition of the second, underlying limitation on Uruguay's export-based economy: the limited supply of livestock products. Production of beef stagnated by the mid-1930s, wool by the mid-1950s. With only minor modifications, ranchers continued to rely on the extensive production techniques used since the colonial period. Livestock production was therefore limited by the carrying capacity of the land. For many years, successful livestock producers had been able to expand their operations by simply purchasing or renting additional land, but after the tremendous expansion of both cattle ranching and sheep ranching during the early decades of the 1900s, this option was no longer available. Producers rejected the obvious alternative of increasing production levels by using more intensive techniques, such as fertilized pastures. According to a study published by the Economy Institute (Instituto de Economía) at the University of the Republic (also known as the University of Montevideo) in 1969, ranchers chose not to invest their profits in improved pastures because many more lucrative investments were available. Preferred investments included manufacturing (after World War II), urban real estate (during the 1950s), and overseas opportunities (leading to substantial capital flight during the 1960s).

The stagnation of livestock production undercut the export model that had brought Uruguay its prosperity. At first the nation was able to avoid complete economic paralysis by turning from livestock production to industrial development, from the dormant countryside to the dynamic city of Montevideo. Like most other Latin

American nations, Uruguay responded to the Great Depression by implementing a policy intended to encourage diversification away from primary products, reduce imports, and increase employment.

The so-called import-substitution industrialization (see Glossary) strategy raised tariff barriers to discourage imports and protect new manufacturing enterprises. In addition to increased protectionism, several other conditions in Uruguay favored the industrialization that accelerated beginning in the mid-1930s. Labor was plentiful in Montevideo; 100,000 immigrants had arrived from Europe during the 1920s. Equitable income distribution also meant that there was a sizable middle-class market for manufactured products. Finally, wealthy livestock producers were ready to invest in new enterprises.

Industry developed rapidly under these conditions. The number of firms, most of them employing ten or fewer workers, tripled from 7,000 in 1930 to 21,000 in 1955. Apart from the growth of traditional types of enterprises (food, beverages, textiles, and leather), there was also substantial progress in heavier industries (chemicals, oil refining, metallurgy, machinery, and electrical equipment). Workers earned good wages, and production increased more rapidly than employment, meaning that labor productivity was on the rise. During the 1940s, industrial output overtook livestock raising as a share of GDP.

But the industrial boom was short-lived. One sign of trouble was the fact that 90 percent of manufactured goods were consumed within Uruguay. Because domestic industries had grown up behind high tariff barriers, they were not competitive on world markets. This common shortcoming of the import-substitution industrialization strategy was particularly serious, given Uruguay's small internal market. Although income distribution was equitable, the potential for home-industry expansion was limited because consumption was limited. Most industries reached their full potential just two decades after the beginning of the industrialization process. During the mid-1950s, imports of machinery and industrial equipment that were essential for the further development of heavy industry leveled off and then declined. Industrial growth ceased. With the stagnation of both industrial production and livestock production in the mid-1950s, Uruguay's economy entered what would be a twenty-year crisis. Real per capita income, which had grown rapidly during the early 1900s, increased at an average of only 0.5 percent per year from the mid-1950s to the mid-1970s. The period was characterized by declining exports, a negative balance of payments, decreasing reserves, and growing inflation.

The prolonged nature of the crisis, i.e., the two-decade lack of fundamental economic restructuring, had much to do with the government policies that were set in motion during the Batllist period. As two of the three pillars of Uruguay's economy (livestock and industry) crumbled, the third (the public sector) bore an increasing burden. State enterprises expanded until, by the 1960s, they generated 30 percent of GDP and paid 40 percent of all salaries. Once-dynamic state enterprises became expensive public works projects. Elaborate formulas were devised to allow Uruguay's two principal political parties—the Colorado Party and the National Party (Partido Nacional, usually referred to as the Blancos)—to dispense public-sector jobs in proportion to votes received. Economically, a change of the ruling party meant very little. Both parties were allied in upholding the social welfare model, which amounted to keeping the state enterprises and the bureaucracy afloat. To do so, they incurred a large foreign debt and penalized the livestock sector through domestic price controls. The economy turned inward through continued protectionism and artificially high exchange rates. As a result, the once-vital export sector could not develop the momentum required to pull the economy out of the doldrums.

The protracted economic crisis became a political crisis in the late 1960s. Within Uruguay the welfare state government could provide no answers to the twin challenges of urban terrorism and growing inflation. Outside Uruguay military regimes in both of its larger neighbors (Argentina and Brazil) cast long shadows, and international economic conditions made the insulation of Uruguay's economy more difficult. As the military regime took power in 1973, two international economic factors were particularly relevant: the quadrupling of oil prices (Uruguay imported all of its petroleum) and the closure of European Community markets to imported beef. These factors helped convince the military government that a major restructuring of the economy was needed.

Restructuring under the Military Regime, 1973–85

The military government was at first able to redirect and revitalize the economy. During the first phase of stabilization and structural adjustment, from 1973 to 1978, government policies had two central goals: to reestablish an export-oriented growth policy and to eliminate inflation. In pursuit of the latter, the government tightened the money supply, sharply cut the public budget, and held real wages down. The effort was partially successful. Inflation declined from over 100 percent per year during the 1960s to about 50 percent per year in the 1973–78 period. To reorient the productive

sectors of the economy, the government eliminated most price controls, lowered tariff barriers from a maximum of 346 percent in 1974 to 180 percent in 1977, and subsidized exports. Foreign-exchange and financial markets were also made more liberal, increasing Uruguay's integration with world markets. The immediate results were dramatic: from 1974 to 1978, GDP increased by an average of 3.9 percent per year, after two decades of stagnation. Real exports grew by 14 percent annually during the same period, and productive investment increased by 16 percent per year.

Dissatisfied with some aspects of the economy's performance, however, the government again adopted several measures between 1978 and 1982. These included passing a foreign investment act (designed to attract foreign investment), reducing government spending, and selling off a few state enterprises.

Inflation, which had dropped below 40 percent in 1976 but had since increased again, remained the primary target of the new stabilization policies. Authorities believed that two factors were fueling inflation: the influx of external funds (allowed under liberalized financial regulations) and the continuing price increases by local firms, still protected from foreign competition because tariffs had only been reduced partially. The government, then, saw continued inflation as a problem caused by incomplete economic liberalization and moved to accelerate reforms. Banks were largely deregulated as reserve requirements were eliminated and foreign currency deposits allowed. Import tariffs for most products were reduced, allowing increased foreign competition. Export subsidies were reduced or eliminated. In addition, the government began announcing moderate exchange-rate devaluations several months in advance in an attempt to slow inflation and discourage currency speculation.

These measures reduced inflation somewhat, but instead of stabilizing the economy, they disrupted the gradual process of economic recovery that had been under way for several years. Uruguayan firms, many of which had reoriented production toward exports after 1974, faced rising internal costs when subsidies were removed. At the same time, they became less competitive abroad because devaluations did not keep pace with inflation. Banks responded to deregulation by making risky loans, many of which became nonperforming as the expansion slowed. The public deficit increased, especially when the government stepped in to rescue several major banks. External debt increased when the government was forced to borrow abroad. A second oil shock in 1979 (the first was in 1973-74) and an Argentine devaluation in 1981 both hurt

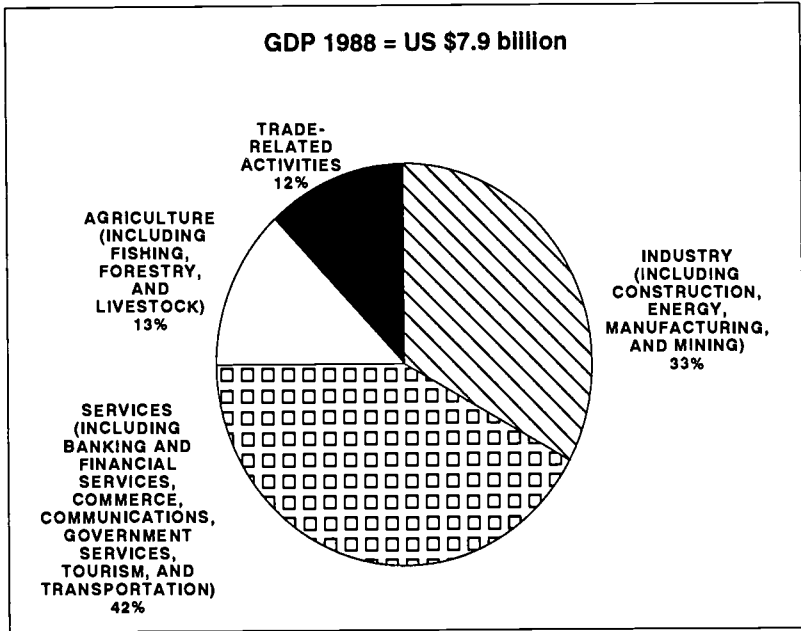
Uruguay's trade balance. As the restructuring process broke down, capital flight became rampant.

The military government's attempt to regain economic stability during its last two years in office resulted in a severe recession. After increasing over several years to a high of 6.2 percent in 1979, GDP growth slowed to 1.9 percent in 1981 and plunged to -9.4 percent in 1982. Real GDP declined by one-sixth from 1982 to 1984. Unemployment increased to 13 percent, further increasing the burden on the nation's welfare system. During its last three years in office, the government's most significant accomplishment was far more modest than its earlier reforms: it reduced the public deficit from 18.4 percent of GDP in 1982 to 9.2 percent at the end of 1984.

As the military government prepared to leave power after a turbulent twelve years, five major issues confronted economic planners. First, the government had succeeded in reorienting production toward exports, but by the mid-1980s traditional export markets were growing less hospitable. For example, world beef prices had fallen, partly because of subsidized competition from the European Community. Second, the public sector, which played a large role in Uruguay's economy, faced a growing internal and external debt burden. This reduced savings available to finance private investment and made it difficult for the government to meet its social security obligations. Third, many firms and banks were financially weak, the former because of debts incurred before the recession and the latter because of nonperforming loans. Fourth, unemployment remained high. Finally, inflation, a primary target of the attempted reforms, had increased from 50 percent in 1983 to 72 percent in 1985. The first and second issues were concerned with enduring themes: the importance of livestock exports and the government's role in the economy. The third, fourth, and fifth issues were products of the reforms that had brought Uruguay out of stagnation without completely restructuring the economy.

The Sanguinetti Government

The civilian government that entered office in 1985 inherited an economy whose fundamental elements had not changed a great deal for many years. The economy was still based on agriculture. In 1988, midway through the Sanguinetti government's term of office, livestock, crop production, and fishing generated only 13 percent of GDP directly. But the largest industries in Uruguay—food processing and textiles—depended on agricultural inputs. Thus, the link between agriculture and industry, which generated 33 percent of GDP in 1988, was strong. Another inescapable feature



Source: Based on information from United States, Central Intelligence Agency, *The World Factbook, 1989*, Washington, 1989, 310; and Economist Intelligence Unit, *Country Report: Uruguay, Paraguay* [London], No. 1, 1990, 3.

Figure 6. Gross Domestic Product (GDP) by Sector, 1988

of the economy was the central role of government. Uruguayan national statistics included the government, which comprised not only agencies such as the Ministry of National Defense and the postal service but also, within the service sector, a large commercial bank and several insurance companies. The entire service sector—including activities such as private banking, transportation, and tourism—accounted for 42 percent of GDP. The external sector, i.e., activities involving foreign trade, generated the remaining 12 percent of GDP (see fig. 6).

The record of the Sanguinetti government was moderately successful. The administration entered office facing an economy just beginning to recover from a severe recession. That recovery continued, as real GDP growth averaged over 5 percent per year during the administration's first two full years in office (see table 9, Appendix). During 1988 and 1989, however, real GDP growth nearly ceased. In other areas, the record was similar. Unemployment fell from 13 percent in 1985 to 9 percent in 1987 but was reduced no further. Inflation fell at first, then increased again.

The lack of sustained economic progress during the late 1980s was not simply a result of the Sanguinetti government's policies, however. The government and the private sector inherited many serious difficulties in the mid-1980s: the growing external debt, a large government bureaucracy in deficit, a burdensome social security system, and a weakened currency. Because they could not immediately change these features, the government and the private sector chose to begin a cautious policy of readjustment. Fundamental restructuring was again delayed.

Economic Policy

Government policy has greatly influenced the development, or lack of development, of Uruguay's economy during the twentieth century. The government first became an important regulator of economic activity when it arranged for a portion of livestock export earnings to be transferred to the urban working class. As its interventionist role expanded during the early 1900s, the central government became the administrator of an elaborate social welfare system that was generous by Latin American standards. After the Great Depression, the government enacted tariff policies to promote domestic manufacturing and adopted the strategy known as import-substitution industrialization. The state also became an important participant in the economy. In a pattern repeated elsewhere in Latin America, the central government nationalized or established several of the largest service and manufacturing companies in the country (see Industry, this ch.). It became the single largest employer and producer in the nation.

The level of government involvement in the economy took on increasing significance after Uruguay entered a period of economic stagnation. When export earnings leveled off in the 1950s, the state's two roles in the economy became difficult to sustain yet vital to the population. Growing numbers of unemployed persons and retirees depended on the social welfare system, even as government revenues used to support that system declined. In addition, the overall economic slowdown made public-sector employment extremely attractive. Public employment, which was controlled by political parties rather than market forces, increased at 2.6 percent per year during 1955–61, while private-sector employment grew at only 0.9 percent. Government consumption expenditures for salaries and services remained high, but public investment was scaled back, penalizing future productivity. Despite this shift in the spending pattern, the state's income did not keep pace with its expenditures. By the 1960s, a public-sector deficit had developed, requiring borrowing from abroad and helping to fuel inflation.

The public-sector deficit was the hallmark of Uruguay's stagnated economy in the 1960s. Thereafter, efforts to reduce the deficit were a central feature of structural reforms. However, the web of government commitments within the economy—involving both administrative and productive activity—made this a difficult task. The military government (1973–85) partially succeeded at the larger task of reorienting the economy toward world markets but made only modest headway against the public-sector deficit. During the second half of the 1980s, the deficit was at first reduced but then increased again in the last two years of the Sanguinetti administration.

Fiscal Policy

The civilian government that entered office in 1985 faced a severe fiscal problem: the chronic public-sector deficit. It also faced a broader difficulty: an economy in deep recession. The deficit was believed to be perpetuating inflation. Inflation, in turn, prevented the economy from reaching a stable position conducive to renewed growth. Thus, the priorities of the Sanguinetti administration's economic plan—devised in cooperation with the International Monetary Fund (IMF—see Glossary)—were to reduce the deficit, bring down inflation, and improve the balance of payments.

These multiyear fiscal measures were considered essential for renewed growth, but the serious consequences of the recession called for immediate action to spur economic activity. Between 1981 and 1984, the recession had taken its toll on all sectors of the economy. GDP had declined by almost 17 percent; agricultural production by 12 percent; manufacturing by 21 percent; construction by 48 percent; and capital formation (investment) by 56 percent. Workers were especially hard-hit by the decline. Between November 1982 and March 1985, real salaries fell by 19 percent. In real terms, workers earned only half of what they had earned in 1968, and unemployment had increased to 13 percent. Unable to ignore these signs of distress, the Sanguinetti administration also adopted an economic growth policy.

Initially, the stabilization effort took precedence over efforts to boost economic activity. The idea was to break the inflationary momentum of the economy first and restore growth second. In fiscal terms, the goal was to reduce the public-sector deficit from 10 percent of GDP in mid-1985 to 5 percent of GDP by 1986. The scope of government involvement in the Uruguayan economy meant that the public-sector deficit had to be attacked on three fronts: the central government, by reducing expenditures and increasing revenues; the Central Bank of Uruguay, which accounted for about half of

the deficit; and the state enterprises, many of which had run small deficits through most of the 1980s.

The results of the stabilization effort were ambiguous. On the one hand, the Sanguinetti government easily reached its fiscal targets. During its first two years in office, the government enacted tax increases that raised real government revenues by 58 percent. Meanwhile, real expenditures increased by only 43 percent (see table 10; table 11; table 12, Appendix). As a result, the public-sector deficit declined to about 3 percent of GDP, better than the government had planned. Simultaneously, however, inflation—the underlying target of the government's fiscal policy—hardly slowed at all. Inflation went from an annual rate of 72 percent in 1985 to 57 percent in 1987, but it increased to 85 percent in 1989. The persistence of inflation in the face of fiscal restraint did not reflect a failure of the Sanguinetti government's fiscal policy; rather, inflation persisted because of the government's monetary and exchange-rate policies, the instruments it used to promote economic growth (see Monetary and Exchange-Rate Policy, this ch.). Fiscal policy was also inadequate because the government expanded the money supply to pay for the fiscal deficit (8.5 percent by the end of 1989).

Monetary and Exchange-Rate Policy

The Sanguinetti administration turned to Uruguay's formerly strong export sector in devising its strategy for renewed economic growth. Through a combination of exchange-rate policy, liberal credit to exporters, and cultivation of new markets, the government hoped to revitalize the traditional export sector (primarily beef and wool) and promote the manufacture of nontraditional exports such as apparel.

The most important policy tool was the exchange rate. Initially, the government planned to allow the peso to float freely, in keeping with its philosophy of minimal market intervention. In practice, however, the monetary authorities carried out a "dirty float," repeatedly entering the currency market to lower the exchange rate of the peso. Devaluation translated into increased competitiveness. For a small country like Uruguay, facing world (United States dollar) prices for goods, a devaluation of the peso (more pesos per dollar) meant that an exporter would receive more pesos for a given quantity of goods. This effectively raised the profitability of exports (leaving aside other effects) and encouraged the growth of the sector.

Exports and GDP both increased after 1985, partly as a result of the more competitive exchange rate. But the policy also had

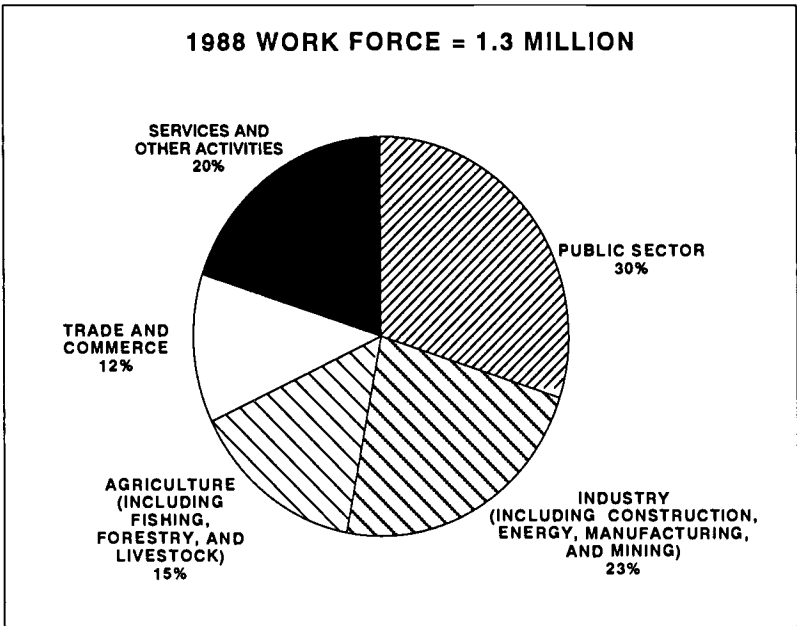


Figure 7. Employment by Sector, 1988

inflationary effects that counteracted the government's restrained fiscal policy. The government's intervention in the currency market consisted of buying foreign exchange and selling pesos. This raised the supply of pesos and lowered their price relative to other currencies (the exchange rate). But the intervention also increased the foreign-exchange component of the money supply, thus fueling inflation. The government attempted to compensate for this increase in the monetary base by decreasing other components of the money supply, a policy known as sterilization. However, an increasing share of Uruguayan bank deposits were denominated in United States dollars rather than pesos. Thus, the efforts to restrict the peso monetary base had little effect on the overall money supply, which continued to increase. As a result, the government could not fine-tune its export-promotion strategy to eliminate inflationary effects. Inflation persisted despite the decline of the public-sector deficit. In short, the government's notable accomplishments on the fiscal side were largely negated on the monetary side.

Labor

The labor force in Uruguay was small (1.4 million in 1990), about

80 percent urban, and educated at least to a high school level. In 1988 about 30 percent of workers were employed in the public sector, 23 percent in industry, 15 percent in agriculture, 12 percent in trade and commerce, and 20 percent in services and other activities (see fig. 7). During the 1970s, workers experienced a sharp decline in real wages, which they only partially regained in the 1980s. The problems of the labor force, reflecting the overall difficulties of the Uruguayan economy, led to widespread strikes and unrest that hindered economic growth during the 1980s. In view of Uruguay's fundamental structural difficulties, an accommodation with the labor movement remained an important issue for the government.

The Labor Movement

Several of the uncommon economic and political characteristics of Uruguay influenced the development of its labor movement during the early 1900s. First, because the only sizable concentration of workers was in Montevideo, the labor movement was largely restricted to that city and was thus not really a national phenomenon. Second, the small number of workers employed by most individual firms limited the tendency of workers to form mass organizations. Third, the government played a central role in labor policy. State enterprises and government organizations became the nation's largest employer. In addition, legislation established many private-sector labor policies that preempted organized labor.

Uruguay's laborers, like the economy as a whole, made great strides during the early decades of the 1900s. Ironically, this progress slowed the growth of a cohesive labor movement. President Batlle y Ordóñez, who firmly supported the working class and the right to strike, was an important figure for laborers during this period. His ideology of Batllism—in sharp contrast to the repression of labor in many other Latin American nations—aimed to reconcile labor and capital, or employees and owners. The Batllist government created the Office of Labor and ensured that a share of the increasing livestock export earnings was transferred to the urban working class. By the late 1920s, legislation limited the workweek and workday, established a minimum wage, and required that benefits be paid to injured or retired laborers. This congenial atmosphere gained the official labor movement only limited support. In 1926, for example, only 6,000 out of 65,000 industrial workers were dues-paying union members.

The cordial relationship between labor and government deteriorated as Uruguay's economic growth stalled in the 1930s. The government became less tolerant of unions. The unions, in turn,

became more militant. Communism replaced anarchism as the dominant political ideology of labor leaders. During and after World War II, a sometimes-violent split between the communist and non-communist labor elements developed. This ideological division prevented the labor movement from speaking with one voice and limited its national impact. In contrast to Argentina, where the Peronist labor movement gained great political power during the 1950s, the labor movement in Uruguay remained fragmented.

An important question for the labor movement in Uruguay has been whether public-sector workers have the right to strike. Government employees—both in government agencies and in state enterprises—constituted the largest group of salaried workers in the country. Thus, the government's civil-service wage policy set the tone for wages in general. The government also participated directly in setting private-sector wage policy, along with unions and owners, through the tripartite advisory boards—the wage councils—established in the 1940s. When public employees tried to strike, the government responded harshly. After a 1952 strike in the petroleum refinery, for example, the government enacted a mild form of martial law.

The confrontation between government and labor became pronounced in the late 1960s. The Communist Party of Uruguay had come to dominate the unions after the Cuban Revolution, and the unions' objectives were as much political as they were economic. The government would not tolerate labor's leftist political program, especially given the charged atmosphere of the period. Nor was the government in a position to fulfill the unions' wage demands; a wage and price freeze was imposed, and the wage councils were abolished in June 1968. Strikes and repression became frequent. The confrontation reached its climax in 1973, when the major labor group, the National Convention of Workers (Convención Nacional de Trabajadores—CNT), organized a general strike to protest the military coup. The strike—the labor movement's last stand—dissolved within two weeks. The military regime that seized power in 1973 outlawed the CNT and arrested its leaders. Union activity ceased for almost ten years. During the 1970s, 12,000 public-sector workers and at least 5,000 private-sector workers were dismissed because of their trade union or political activities.

The military government allowed unions to resurface in 1981 through the Law of Professional Associations. Labor organizations were allowed to exist on three levels: by individual enterprise, by occupational category, and on a national scale. But the government took pains to depoliticize the labor movement. The secret ballot was to be used on the individual enterprise level, both for

election of leadership and for strike votes. Leaders of previously outlawed organizations were admonished to limit their political activity. The law's timing was more important than these limitations, however. As economic activity slowed during the 1981-84 recession, union activity was minimal. Nevertheless, the unions did play a role in the "democratic counteroffensive" that led to the restoration of civilian rule in the mid-1980s. Successful general strikes before and after Sanguinetti's election helped dissuade the military from interfering in the political process.

Relations between labor and government were delicate during the Sanguinetti administration (see *Political Forces and Interest Groups*, ch. 4). The framework for relations was established before the civilian government took office, during the 1984-85 period of multiparty consultations, officially called the National Conciliatory Program (*Concertación Nacional Programática—Conapro*). A working group recommended that the incoming government adopt a three-part policy toward labor: repeal of the legislation that restricted union activity and collective bargaining; reinstatement of all public-sector employees who had been dismissed by the military regime for their union activity; and restoration of workers' purchasing power through periodic wage increases, but in a manner consistent with bringing down inflation. The new government quickly complied with the first two recommendations, but the third became a contentious issue.

Government Policy

The Sanguinetti administration attempted to balance the clear need to increase wages with the equally pressing requirement to control inflation. Thus, the government immediately declared a wage increase in March 1985 but took action designed to control future wage increases. The tripartite wage councils were reestablished to negotiate wages every four months for nonagricultural private-sector employees. The councils at first adopted wage increases that were slightly higher than inflation, so that real wages at the end of 1985 were an average of 15 percent higher than the year before. Nevertheless, there was a great deal of labor unrest: over 900 strikes occurred between March 1985 and September 1986. Workers were apparently frustrated by the slow increases in real wages and anxious to express their displeasure after a decade of repression.

After 1986 the number of labor disputes decreased, partly because of the government's bargaining strategy. The government tried to control wage increases by persuading all private-sector unions to sign twenty- to twenty-four-month contracts under which

wages would be adjusted according to conditions within individual companies. This action helped lower the level of conflict between labor and government, but it may have made the task of restraining wage increases more difficult. In exchange for accepting longer wage contracts, unions demanded that workers be protected against inflation through "indexation," or automatic wage increases, to compensate for inflation. In 1986 about one-third of all workers were covered by indexed contracts; by the end of 1988, over half were. When Sanguinetti proposed in mid-1988 that wage increases be held to 90 percent of inflation, instead of the 100 percent or greater that unions had become accustomed to, most of the nation's work force joined a one-day work stoppage in protest. The position of workers was understandable: their average real wage (purchasing power) remained below its 1968 level (see *Blue-Collar Workers*, ch. 2). The wage issue, particularly the question of whether indexation was compatible with an anti-inflationary policy, was still unresolved when Lacalle took office in 1990.

Agriculture

Agriculture played a central role in Uruguay's economy. In 1988 agricultural activity (including fishing) directly generated 13 percent of GDP and provided over half the value of exports. Indirectly, agriculture was responsible for a much higher proportion of both GDP and exports. Many of Uruguay's most dynamic manufacturing enterprises—such as its tanneries and textile mills—depended on agricultural inputs. The close relationship between agriculture and manufacturing had a significant impact on Uruguay's economic development. For example, the sluggish performance of the large livestock sector in the 1980s contributed to slow overall economic growth (see table 13, Appendix).

Agricultural Stagnation

A troubling issue for the agricultural sector was the stagnation of production levels over several decades. Total agricultural production increased at an average rate of less than 1 percent per year from the 1950s to the 1980s. In 1989 the sector continued a 1 percent growth rate. This low growth was usually attributed to a lack of technologically advanced production methods, but that description applied mainly to the large livestock sector. Ranchers continued to rely on extensive production methods. By contrast, many crop and citrus farmers had adopted more advanced technology, using tractors, fertilizers, and pesticides. Similarly, poultry producers relied on advanced techniques, and some dairy farmers fertilized their pastures.

Alternative explanations of the agricultural sector's poor performance take note of the overall characteristics of Uruguay's economy. First, the small size of the internal market had forced most agricultural producers to be exporters. Agricultural products had become an important source of foreign exchange, but fluctuations in world prices and markets buffeted Uruguay's externally oriented agricultural sector. For example, wool prices fell when synthetic fabrics were developed. Additionally, the market for Uruguayan beef contracted when the European Community began subsidizing its beef producers in the 1980s.

A second reason for the lack of agricultural growth may have been the inconsistency of government policy. During the protectionist import-substitution industrialization phase in the 1950s, the government held agricultural prices down in order to lower industrial labor costs. This discouraged both agricultural production and investment. During the 1960s, the government reversed this pricing policy when it encouraged the export of certain agricultural products (poultry, dairy, and citrus products) through subsidies and other incentives. However, this export policy was itself reversed in the 1970s, in keeping with the military government's effort to open the economy to foreign competition. The abrupt withdrawal of subsidies made the production of several products unprofitable. With government policy toward it fluctuating in this manner, agriculture in Uruguay was on uncertain ground, and potential investors remained wary. Aided by a recovery in the livestock sector, however, agricultural output increased by an estimated 3.5 percent in 1990.

Land Use and Tenure

The general characteristics of Uruguay's land area helped determine the pattern of land use. The countryside is devoid of mountains—in contrast to most other Latin American nations—and is only 2 to 3 percent forested. Over 80 percent of the land can be used for some kind of agriculture. The natural grasslands for which Uruguay is famous lend themselves to the predominant agricultural activity: livestock production.

Although the land and temperate climate facilitated livestock production, the limited fertility of the soil hindered the production of crops. Livestock ranches covered three-quarters of the total land, especially in the departments of Artigas, Cerro Largo, Durazno, Flores, Lavalleja, Maldonado, Paysandú, Rivera, Rocha, Salto, and Tacuarembó (see fig. 1). The most productive wheat and cereal-farming area was the southwest (Colonia, Río Negro, and Soriano departments); most of the rice was produced in the

east (Treinta y Tres Department); and fruits, vegetables, and wine were produced in the departments of Canelones, Florida, and San José.

Uruguay was no exception to the Latin American pattern of concentrated landownership, but its small population had kept land distribution from becoming a major political issue. Agricultural enterprises could be roughly divided into two types, whose characteristics in the mid-1980s reflected the concentration of landownership and helped explain Uruguay's urban tendencies. The first type, family-operated (owned or rented) farms and ranches, made up 85 percent of agricultural enterprises in the country, employed 68 percent of rural workers, and produced 45 percent of all agricultural output. But this type of enterprise controlled only 25 percent of agricultural land (farming and livestock). The second type, larger commercial enterprises, controlled 75 percent of the land, employed 32 percent of rural labor, and produced 55 percent of output. These statistics indicate that smaller enterprises made more productive use of the land. However, the fact that such family-operated farms and ranches employed mostly family members rather than salaried workers tended to limit the development of the rural economy. The larger enterprises, by contrast, were mostly extensive livestock ranches that had little need of hired labor. As this second type of enterprise became more prevalent throughout the twentieth century, landownership became more concentrated, and the population of the countryside declined.

Agricultural production employed only about 15 percent of Uruguay's labor force in the late 1980s. The agricultural work force declined steadily as the number of small agricultural enterprises diminished. There were 87,000 farms and ranches in 1961, 77,000 in 1970, and only 57,000 in 1986. The importance of family-operated establishments is clearly seen in rural labor statistics. In 1980 two-thirds of the 160,000-person agricultural labor force was made up of landowners or their relatives; only 57,000 workers were wage earners. Not surprisingly, the labor movement had little impact on rural workers, although both the rice workers and the dairy workers were organized into unions.

Livestock Ranching

Uruguay's livestock herds did not expand appreciably after 1930. In 1908 there were 8 million cattle and 26 million sheep in the country. In 1981 the number of cattle peaked at 11 million, while the number of sheep had declined to 20 million. Because the land area dedicated to livestock raising has not changed significantly, these figures illustrated the lack of progress in the sector. The single

*Herding cattle in Treinta y Tres
Department
Courtesy Inter-American
Development Bank*



*Inspecting a beef carcass
in Melo
Courtesy Inter-American
Development Bank*



largest investment in cattle herds was complete by 1930, when Herefords were substituted for the original mixed breeds. Extensive ranching methods facilitated livestock raising because little investment was required. But these methods also limited the carrying capacity of the land and the size of the stock. By the 1970s, it took twenty-six Uruguayan cattle to yield one ton of beef, compared with about eighteen in Argentina and about thirteen in the United States or Western Europe. The production of wool and mutton per head of sheep was also low: 3.5 kilograms of wool per head, compared with over 5 kilograms per head in Australia or Argentina. In addition, both cattle and sheep herds were subject to losses because of limited efforts to prevent disease.

The vulnerability of the range-fed livestock herds was further demonstrated in the late 1980s when Uruguay experienced a severe drought. Millions of animals died or had to be slaughtered prematurely. The drought lasted longest in the center of the country, where most of the largest cattle ranches were located (the departments of Cerro Largo, Durazno, and Tacuarembó). The leading sheep-ranching departments in the northwest (Artigas and Salto) were not as severely affected.

Raising sheep for wool in Uruguay became less profitable during the 1960s. There was increasing worldwide competition from petroleum-based synthetic fibers. After the oil price increase in 1973, however, wool was once again in favor. Production surged from about 61,000 tons per year in the mid-1970s to 87,000 tons in 1986. Wool surpassed beef as Uruguay's most valuable export in the early 1980s. It also supplied the growing woolen textile and apparel industry, which earned additional foreign exchange.

Sheep, whose stock increased to almost 26 million by 1989, were also raised for lamb and mutton. The potential for Uruguay's export of sheep meat in 1989 was about 3 million head, as compared with annual exports of about 2 million head in the early 1980s. However, a severe drought in the first half of 1989 reduced the performance of this subsector by about 10 percent during that period.

Rising world beef prices stimulated the Uruguayan cattle industry in the late 1970s. At first, rising prices increased the profitability of cattle ranching but ultimately led to considerable instability in the sector. When many ranchers expanded their herds after the 1978-79 beef price increases, the price of pastureland grew almost tenfold. Because real interest rates were low or negative, ranchers were willing to borrow heavily to increase their landholdings. But beef prices soon leveled off, and many ranchers were left with large, unpayable debts. Land prices fell sharply; banks could not cover

their loans even by foreclosing. As the bank crisis mounted, the Central Bank stepped in to provide refinancing in United States dollar-denominated loans. Most ranchers avoided bankruptcy but had to slaughter record numbers of cattle to service their debts. Many ranchers took the opportunity to switch to sheep ranching because wool appeared to face more stable world demand. Thus, Uruguay's cattle herds declined by 20 percent from 1981 to 1984.

Cattle ranchers rebuilt their herds during the latter half of the 1980s but were hindered by limited credit and severe drought. Damage from the prolonged drought had reached alarming proportions by the end of 1989, when the cattle stock was down to 9.4 million head. The number of cattle fell by 738,000 head between June 1988 and June 1989, the largest annual drop in fifteen years. About 2 percent of the total had died, and the rest had been killed and sold (50 percent more than usual). In the July-November 1989 period, the beef cattle herd was depleted by an additional 622,000 head. The increased slaughter rates allowed meat-packing plants to pay less for beef, decreasing ranchers' profits.

The continuing difficulty in the sector prompted the government to launch Operation Manufacture in March 1989. The program eased the ranchers' financial burden by extending them a special line of credit, lowering their tax rate by 20 percent, and providing for case-by-case assistance. The government also announced the opening of a line of credit with terms of up to eight years for herd replacement. Sheep ranchers, who suffered fewer losses from the drought, were not eligible for these government programs.

The dairy industry, based in the departments near Montevideo, expanded considerably in the 1980s. Milk production increased from 400,000 tons in 1979 to 635,000 tons in 1987. Even though many dairy farmers still relied on natural pastures, limiting the milk output per cow, Uruguay was more than self-sufficient in dairy products and exported to other Latin American countries. Most domestic milk processing and marketing was controlled by the National Dairy Products Cooperative, which distributed dairy products throughout the country.

Crop Production

Crop production in Uruguay has never been as important as livestock raising. Only about 8 percent of the land area was dedicated to growing crops in the mid-1980s, compared with 75 percent dedicated to livestock. The amount of land under cultivation has varied according to the world price of livestock products. When beef prices have declined, for example, ranchers have planted wheat or corn. Rising livestock prices in the 1980s resulted in a considerable

decrease in the area dedicated to most crops. Because crop production had gradually become more efficient through mechanization, however, crop yields did not necessarily decline.

Although crop yields per hectare had generally increased, erosion of the thin topsoil layer became a significant problem in Uruguay during the 1980s. It was estimated that 30 percent of all arable areas had been adversely affected. The ill effects were most serious in areas that had been under continuous cultivation for long periods.

Rice surpassed wheat as Uruguay's most significant crop in the 1980s. In contrast to the general downward trend in farmed land area, the land dedicated to rice production increased from 55,000 hectares in 1980 to 81,000 hectares in 1988. Over this same period, production rose from 228,000 tons to 381,000 tons, a 67 percent increase. Only about 40,000 tons were consumed domestically; most of the rice was exported. The preferred farming system for rice production was closely connected to livestock raising. Rice was grown for two years; then the land was sown as pasture for four or five years to renew the fields and provide grazing for cattle. The most common variety produced was the American "Blue Belle" type. The drought that gripped Uruguay in 1988-89 caused rice producers to lose an estimated 6 percent of their crop, worth about US\$2.4 million. The hardest hit areas were in the north, in the departments of Artigas, Rivera, and Tacuarembó.

Wheat production and hectareage both declined during most of the 1980s. This decline reflected the increasing land area dedicated to livestock production and the fact that Uruguayan wheat producers could not effectively compete with wheat producers in other countries. International competition became more important after the government discontinued its subsidies for wheat farmers during the economic liberalization of the 1970s. Uruguay was no longer self-sufficient in wheat production by the mid-1980s, when about 80,000 tons per year were imported. Wheat farming was largely mechanized by the 1980s, but advanced tractor equipment acted mainly to reduce the labor requirement on farms, rather than leading to huge production increases. Most farmers made only limited use of pesticides and fertilizers. Thus, wheat production per hectare was below that of most other countries. Nevertheless, the area dedicated to wheat farming rose in 1989, and production was expected to begin increasing again. Indeed, wheat production grew to 414,000 tons in 1988.

Corn production stagnated during the 1980-88 period. Like wheat farmers, corn farmers were adversely affected by the government's freeing of agricultural prices in the late 1970s. Unlike wheat,

however, corn was not an important commercial crop; farmers used it primarily to feed their animals. No longer self-sufficient, Uruguay imported almost US\$2 million worth of corn in 1988. Some farmers had substituted sorghum cultivation for corn because it provided roughly the same nutrition as corn but better withstood drought conditions.

Other crops produced in Uruguay in the 1980s included barley, soybeans, oats, sunflowers, peanuts, sugarcane, potatoes, flax, and cotton. Barley, soybeans, and sunflowers were produced mainly for export; the other crops were produced on only a small scale for the domestic market. Production of sugar was uneconomical, relying on a large government subsidy. Uruguay imported cotton (US\$6.6 million in 1988) for its textile industry.

Citrus farming was a bright spot on the agricultural horizon in the 1980s. Citrus and produce farms were originally established around Montevideo to supply the city with fruits and vegetables. During the 1980s, these farms expanded, allowing Uruguay to become a net exporter of citrus fruit (oranges, lemons, and grapefruit). The exported value increased from US\$5 million in 1980 to US\$21 million in 1986. One large-scale citrus plantation added packing facilities and a juice-and-oil plant, with at least half of its production intended for export. The government encouraged such diversification of agriculture.

Fishing

Uruguay first began to develop a fishing industry in the 1970s. Previously, fishermen from other countries had taken advantage of the rich resources off Uruguay's coast, but there was no concerted national fishing effort. The military government enacted the five-year National Fishing Development Plan in 1974 as part of its attempt to develop new economic activities with export potential. Under the plan, administered by the government's National Fishing Institute, fishing expanded markedly. By the late 1980s, there were over 700 fishing vessels in the fishing fleet, compared with only 300 in 1974. Furthermore, the number of large ocean-going vessels increased from five to seventy during this period. Ocean-going vessels held more fish and allowed longer voyages to distant waters. The latter capability became important after most nations (including Uruguay and neighboring Argentina) extended their exclusive economic zone from 3 to 200 miles in the mid-1970s, restricting access to many coastal fisheries. As the fishing fleet expanded, port facilities were improved. The port facilities of Montevideo, Piriápolis, and Punta del Este were modernized, and an entirely new port was constructed at La Paloma.

The intensified fishing effort produced favorable results; the catch grew from 16,000 tons in 1974 to 144,000 tons in 1981, remaining at about 140,000 tons per year in the late 1980s. Not all aspects of the government's plan were successful, however. It called for sizable catches of species that could be processed (canned) for export, such as tuna and sardines. As of 1987, however, fishermen were only catching a few hundred tons of tuna per year, not enough to supply a cannery. The sardine catch was also very small. Although those two species proved difficult to catch, Uruguay's fishermen had success catching Argentine hake, Atlantic croaker, and striped weakfish. The fish-processing industry also developed as the catch increased. Processing capacity in the late 1980s was about 250,000 tons, considerably above the estimated annual catch of 200,000 tons for all kinds of fish, except the anchovy.

About half of Uruguay's catch was exported during the late 1980s, in line with the government's goal of increasing nontraditional exports. Argentine hake (a whitefish similar to cod) was the leading export. In 1988, however, Uruguayan processing companies reported that world prices for Argentine hake had fallen below production costs because of the competition from cod suppliers. Although prices later recovered, many companies began to process and export alternative species, such as anchovy, mullet, and bluefish. The industry's exports reached US\$81 million in 1987, as compared with US\$65 million in 1986 and US\$1.2 million in 1974. The United States imported 30 percent of Uruguay's fish; Brazil imported 23 percent; and Japan, the Federal Republic of Germany (West Germany), Saudi Arabia, and Israel each imported between 4 and 6 percent.

In 1990 an important issue for the Lacalle administration was Uruguay's access to the fisheries of the South Atlantic near Antarctica, as well as to fishery resources in Argentina's coastal waters. Lacalle told *Visión* magazine in early 1990 that he strongly supported the idea of an international conference, under the auspices of the Food and Agriculture Organization of the United Nations, to regulate fishing in the South Atlantic.

Forestry

In the 1980s, estimates of Uruguay's natural forest ranged from 4,000 to 6,000 square kilometers of mostly small trees of limited or no industrial use; planted forest estimates ranged from 120,000 hectares to 137,000 hectares of pine and eucalyptus. There were an additional 70,000 hectares of palm, poplar, salix (a genus of shrubs and trees), and other species. Sawmills were inefficient and small, with a capacity of fewer than thirty cubic meters a day. Of



*Harvesting oranges near Paysandú
Courtesy Inter-American Development Bank*

the 220,000 cubic meters of sawn wood consumed per year, Uruguay imported about 66,000. Following the recovery of the construction industry from a recession in 1987, demand for sawn wood was increasing at a rate of about 2.5 percent per year in the late 1980s. Domestic use of firewood was important, increasing from about 1.4 million cubic meters in the mid-1970s to 2.8 million cubic meters in the mid-1980s. Firewood demand was growing at 5 percent a year in the late 1980s. A number of local industries converted to firewood from fuel oil for energy needs, resulting in significant savings.

Industry

Uruguay's industries, including construction, mining, and energy, generated 33 percent of GDP in 1988. These industries underwent most of their development behind high tariff barriers in the 1950s. As a consequence, the industrial sector was geared mostly to the domestic market. The small size of the internal market limited the growth of manufacturing and prevented many industries from achieving economies of scale. In addition, the substantial level of protection meant that Uruguayan consumers paid high prices for domestically produced goods, which faced no international competition. During the 1970s and 1980s, Uruguay's protectionist

apparatus was partially dismantled, and industry began adjusting to the world market.

Background of Industrial Development

In the early twentieth century, Montevideo was home to many small artisanal workshops. These cottage industries were already protected by tariff rates of about 30 percent on most products. Rapid industrial growth did not occur until the 1930s, when the economic crisis caused by the Great Depression forced Uruguay, like other nations, to become more self-sufficient. Industry accounted for only 12 percent of GDP in 1930 but increased to 22 percent by 1955. The most dynamic growth occurred after World War II. During the presidency of "industrial populist" Luis Batlle Berres (1947-51), the government encouraged the development of industry through several policies: multiple exchange rates were introduced to allow manufacturers to import essential machinery at subsidized rates; import tariffs on competing goods were raised to prohibitive levels; and urban wage increases stimulated domestic demand (see Neo-Batllism, 1947-51, ch. 1). Industrial output doubled during the decade following World War II. The timing of the expansion was favorable. For part of the period, wool exporters earned record profits because cold-weather uniforms were needed for the Korean War. A share of those profits financed the industrial sector's imports of capital equipment.

The industrial boom was short-lived, however. Manufacturing output increased by only 14 percent between the mid-1950s and 1970. For the industries geared to the internal market, the main problem was the small size of that market. The food-processing and textile companies, however, produced goods for export as well as for internal consumption. For these enterprises, the stagnation of the agricultural sector was a serious blow. As M.H.J. Finch argues in his landmark study, *A Political Economy of Uruguay since 1870*, the lagging supply of agricultural inputs limited manufacturing output. The process of economic decline was circular: the decrease in exports meant lower domestic income and hence lower domestic demand for other manufactured products. Additional factors also contributed to the slowdown, such as the bias against exports, which was the result of an overvalued currency. In sum, import-substitution industrialization allowed manufacturing to increase, but only to a limited extent. More important, the policy insulated the economy and eroded much of Uruguay's capacity to export.

The military government that assumed power in 1973 attempted to revitalize the economy by reemphasizing exports. The government dismantled part of the protectionist structure surrounding

industry, lowered trade taxes, and created incentives for nontraditional exports. The results were at first dramatic. Industry grew at a rate of about 6 percent per year from 1974 to 1980. The most dynamic manufacturing growth involved relatively sophisticated goods: electrical appliances, transport equipment, textiles, paper, and nonmetallic minerals. Manufacturers invested in new technology, and labor productivity increased rapidly. Argentina and Brazil became important export markets for manufacturers, proving that Uruguayan industry could compete outside of its own borders.

The expansion came to an abrupt halt in 1981, largely because of factors beyond industry's control. Macroeconomic instability—in part related to developments in the export markets of Argentina and Brazil—pitched the entire Uruguayan economy into recession. The reversal was particularly painful in the industrial sector because manufacturers had borrowed heavily for investments and were overindebted as the recession began. Financial costs actually exceeded labor costs for many manufacturing firms. Thus, lower real wages brought on by the recession were not enough to restore the firms' competitiveness. In 1983–84 the central government stepped in and took over part of the industrial sector's debt. This probably prevented widespread bankruptcies but also increased the public sector's financial burden. The lingering indebtedness of private firms was a major issue for the Sanguinetti government.

Autonomous Entities

The performance of the autonomous entities (autonomous agencies or state enterprises; see Glossary), which played a central role in Uruguay's economic development, was an even greater issue. Most of the autonomous entities were industrial or utility companies; others were service related (see table 14, Appendix). The two largest autonomous entities were also the two largest companies in Uruguay: the National Administration of Fuels, Alcohol, and Portland Cement (Administración Nacional de Combustibles, Alcohol, y Portland—ANCAP) and the National Administration for the Generation and Transmission of Electricity (Administración Nacional de Usinas y Transmisiones Eléctricas—UTE). In 1988 ANCAP, whose primary activity was refining and distributing imported crude oil, grossed US\$470 million, had profits of US\$12 million, and employed 6,700 workers; UTE grossed US\$285 million, had profits of US\$12 million, and employed almost 12,000 workers. (Based on their 1988 gross earnings, ANCAP and UTE were the 113th and 242d largest companies in Latin America, respectively.) Other important autonomous entities (and monopolies) included the National Administration of Ports (Administración

Nacional de Puertos—ANP; another name for the Montevideo Port Authority), the National Telecommunications Administration (Administración Nacional de Telecomunicaciones—ANTEL), and the State Railways Administration (Administración de los Ferrocarriles del Estado—AFE).

The Sanguinetti government's policy toward the state enterprises had two aspects. First, the government planned to invest US\$1 billion in public-sector projects during the 1987–89 period, raising government investment from 2.9 percent of GDP in 1986 to 5 percent of GDP in 1987–89. This target was not met, however. Public investment in 1987 and 1988 increased only to 3.1 percent and 3.4 percent of GDP, respectively, because of the need to restrain spending. Second, the government planned to improve the fiscal health of the state enterprises, many of which were running deficits. A combination of utility rate increases and spending cuts (but no significant cuts in employment) made most state enterprises profitable by the late 1980s, easing the public-sector deficit slightly.

Private Firms

The two largest subsectors within manufacturing, both by output and by employment, depended on agricultural inputs. Food and beverage companies, which accounted for about 30 percent of the value of industrial output in 1987, included meat packers, soft drink companies, and wineries (see table 15, Appendix). These companies exported about one-third of their output. A new entry into the food-processing industry was the Azucitrus citrus plant in Paysandú, which opened in mid-1988. The textile and apparel industry, accounting for about 20 percent of manufacturing output, depended on supplies of both wool and leather for jackets and footwear. The capacity to export was an important asset, allowing firms to withstand fluctuations in domestic demand. For example, the textile industry's sales to the domestic market decreased 23 percent in 1988, compared with 1987, but its exports increased 36 percent during the same period. Other important manufactured goods included chemicals, most of which were exported; transportation goods, including a few thousand automobiles and trucks that were assembled each year; and metal products.

Construction

Activity in the construction industry fluctuated dramatically during the 1980s, appearing to be markedly affected by trends in GDP growth or contraction, but with a one- or two-year lag. One index of such activity, the quantity of private structures built, went from about 2.1 million square meters per year in 1980–81 (when the

recession was beginning) to 500,000 square meters per year in 1985–86 (after the recession had ended). In the late 1980s, construction partially recovered. The industry achieved a 4 percent growth in 1988 because of a construction boom in Maldonado and Punta del Este, and it grew 11.7 percent in 1989. Continued moderate growth was expected because of infrastructure projects such as the modernization of ports and highways, to be financed by international organizations. An offsetting factor, however, was the government's need to reduce expenditures.

Mining

Mining has never played an important role in Uruguay's economy. However, Uruguay has exported granite and marble. In addition, semiprecious stones have been found in quantity. Investment in mining activities was expected to reach at least US\$200 million during the first half of the 1990s. After Uruguay's General Assembly passed legislation allowing foreign investment in mining, two companies, Canada's Bond International Gold and Brazil's *Mineração e Participação* (Mining Copartnership), announced plans to search for gold, silver, and other metals. Bond International Gold was given exclusive rights to develop the Mahoma gold mine, expected to produce more than 900 kilograms per year. Part of the project was to be financed through a debt-for-equity conversion program. The National Mining and Geology Institute indicated that at least fourteen other areas in the country might contain deposits of precious or base metals.

Energy

Hydroelectricity and imported petroleum were the primary sources of energy in Uruguay. During the 1980s, the nation reduced its dependence on imported crude oil and increased its hydroelectric capacity. At the beginning of the decade, three-fourths of Uruguay's energy came from imported oil; by 1987 less than half did. This trend toward hydroelectric power was interrupted during 1988 and 1989 because of a severe drought. Oil-burning power stations had to be brought on-line temporarily, increasing energy costs. In addition, rotating power outages were instituted in Montevideo and other cities. Partly because of such conservation measures, total consumption of energy actually decreased during the late 1980s. Real growth in the utilities sector declined by 12.2 percent in 1989.

The single largest source of hydroelectricity was the Salto Grande Dam on the Río Uruguay, built and operated in cooperation with Argentina. The US\$1 billion dam was completed in 1982 and supplied 1.8 million megawatt-hours of energy to Uruguay in 1987

(before the drought), or 40 percent of Uruguay's electricity. In 1989 the huge project was reported to be facing serious financial difficulties. The Uruguayan and Argentine state-owned power companies were US\$45 million and US\$250 million behind in payments, respectively, to banks and foreign creditors, and absorption of the debts by the two nations' central banks was expected.

Three other hydroelectric power sources were located on the Río Negro. Of these, the El Palmar Dam (located at Palmar), built and operated jointly with Brazil, was the largest and newest (in full operation since 1983); in 1988 it had a capacity of 330 megawatts. The Baygorria Dam and the Gabriel Terra Dam (the latter in operation since 1948) had a capacity of 108 megawatts and 128 megawatts, respectively, in 1988.

The Sanguinetti administration's policy was to improve the existing hydroelectric facilities rather than embark on new projects. Emphasis was placed on extending the electrical distribution network in rural areas. In 1988 the rural electrical network spanned 1,400 kilometers, more than double the 630 kilometers in 1984. The government approved a total of US\$139 million in investments in 1988-89 by UTE, mostly in the distribution program.

Uruguay had no domestic oil resources, despite several exploration efforts. The nation imported mostly crude oil, which was then refined by ANCAP and a few small plants (see External Sector, this ch.). In 1985 ANCAP had a refining capacity of 40,000 barrels per day; its facilities were upgraded during the late 1980s.

Services

Uruguay's service sector, comprising the major subsectors of banking, transportation, communications, and tourism, as well as the activities of the large central government, accounted for 42 percent of GDP in 1988. Transportation, storage, and communications together accounted for about 6 percent of GDP, while banking and commerce accounted for about 15 percent. Thus, half of the so-called service sector consisted of government activity.

On the one hand, the service sector was a strong point in the economy because of the well-educated work force concentrated in Montevideo. On the other hand, the instability among banks, the lack of a modernized telecommunications system, and shortcomings in the nation's transportation infrastructure held back the sector's development. In the second half of the 1980s, these issues took on increasing importance as the government began promoting the idea of Uruguay as an international service center for the Southern Cone (Argentina, Bolivia, Chile, Paraguay, and Uruguay). The growing potential to export services and to integrate them across

*The spillway
at the Salto Grande Dam
The Fray Bentos
Bridge over the Río Uruguay
Courtesy Inter-American
Development Bank*



borders was considered a key element in the future development of Uruguay's outward-oriented economy.

Banking and Financial Services

Uruguay's banking sector was headed by the Central Bank of Uruguay (Banco Central del Uruguay; hereafter, Central Bank), founded in 1967 and charged with regulating the nation's banking and financial system and performing such standard central bank functions as controlling the money supply, regulating credit, issuing currency, controlling foreign exchange, and overseeing the operations of the nation's private commercial banks. The Bank of Uruguay (Banco de la República Oriental del Uruguay—BROU), founded in 1896, had performed some of the functions of a central bank prior to the creation of the Central Bank. An autonomous entity, it remained in 1990 the country's largest and most significant commercial bank. The banking sector also included the Social Welfare Bank (Banco de Previsión Social), the Commercial Bank (Banco Comercial), and several other state-owned banks, such as the Mortgage Bank of Uruguay (Banco Hipotecario del Uruguay) and the State Insurance Bank (Banco de Seguros del Estado), as well as a number of private commercial and savings banks.

In the late 1980s, Uruguay's financial sector was still feeling the effects of a profound banking crisis that had begun early in the decade. The crisis had its origins in the rapid expansion of credit to the private sector during the 1978–82 period. The unrestrained expansion of credit was made possible by the deregulation of the banks. As part of its effort to reorient the Uruguayan economy to the external market, the military government removed or reduced most restrictions on banks, including reserve requirements (which limit the amount of loans that can be made, relative to bank deposits), interest rate ceilings, and foreign currency regulations. The sudden removal of these and other restrictions encouraged banks to expand the supply of credit. The demand for credit also expanded because rising prices for exports convinced many ranchers and manufacturers to invest in land or equipment. The first signs of trouble came from the livestock sector. When world beef prices fell in 1980, rural land prices began to decline sharply, and ranchers began to have difficulty servicing their loans (see *Livestock Ranching*, this ch.).

The crisis became widespread after the economy went into recession in 1981. By 1982 one-quarter of all loans to the private sector were considered nonperforming. The increasing dollarization of credit complicated the situation. Banks that had received large United States dollar deposits also made loans in dollars in order

to avoid exchange-rate risk. The trend toward dollarization increased in early 1982 because banks expected a major peso devaluation. By late 1982, about 60 percent of all loans were denominated in dollars. When the fixed peso exchange rate was finally abandoned toward the end of the year, leading to a large peso devaluation, many already-troubled private companies, which earned pesos on the domestic market, suddenly faced dollar-denominated loans whose peso value had tripled.

Government intervention was required to prevent widespread bankruptcies. BROU devised a two-part strategy for dealing with the crisis. First, it provided credit to the private banks so that loans could be refinanced. About one-fifth of all outstanding loans (worth US\$400 million) were refinanced by late 1982, allowing debtors a two- or three-year grace period and a lengthened repayment schedule. The loans were still in dollars, however, so that further devaluations of the peso remained a difficulty for debtors. BROU's second action was to acquire many loan portfolios from the private banks. The government thus propped up several private banks, actually buying out four of the twenty-four banks in the country. This policy prevented a banking collapse but significantly increased BROU's obligations, making it responsible for a large share of the public-sector deficit.

The financial sector remained in a precarious condition as the Sanguinetti government took office. By the end of 1984, the banking system had a negative net worth. In 1985, however, the banking system raised US\$400 million in new dollar deposits. Although overall economic conditions improved during the first three years of the Sanguinetti administration, credit remained restricted and interest rates high, making it difficult for even solvent borrowers to obtain new loans. The government continued its efforts to strengthen the banks. For example, it planned to spend US\$160 million in 1989 to restructure the four banks bought during the height of the banking crisis so that they could be sold to the private sector. Critics charged that these banks were too highly indebted, inefficient, and overstaffed to be sold. As of mid-1989, all but one of the banks remained under the supervision of BROU, Uruguay's largest bank (a state enterprise). One bank, the Commercial Bank, was sold to a group of international investors in 1990.

Dollarization of the banking system continued to increase. The proportion of money held in United States dollar accounts reached 84 percent in 1989. The major source of these funds was Argentina, whose savers sought a safe haven and a dependable currency. Uruguayan savers placed deposits in dollars to avoid exchange-rate fluctuations. Thus, the openness of the banking system may

have prevented some capital flight, but the dollarization of bank deposits made it difficult for the government to conduct a monetary policy because the money supply could not be tightly controlled. Nevertheless, the government did not restrict the banking system to deposits in pesos, encouraging instead the further internationalization of Uruguay's banks, most of which were foreign owned. In addition, liberal offshore banking rules (for transactions among nonresidents) were introduced in 1989.

Although Lacalle supported the idea of Uruguay as an international banking center, he indicated in early 1990 that his administration planned to introduce legislation under which bank secrecy i.e., anonymous accounts, would be lifted in cases where illegal drug-money laundering was suspected. The government was pressured to change that aspect of its banking regulations after an alleged Colombian "drug lord" told United States officials that he and others often used Uruguayan accounts.

Transportation and Communications

Uruguay's small size and relatively flat terrain have made development of an excellent transportation network easy. By most accounts, the country had one of the best domestic highway and rail systems in Latin America. The country's location in the Southern Hemisphere, far from many of its trading partners, however, and its lack of land links with neighboring countries have been a hindrance in the past to foreign trade and transportation. New technologies, including the introduction of refrigerated ships early in the twentieth century and later the airplane, have improved access to distant markets. Moreover, since the 1970s the country has made a concerted effort to upgrade links with neighbors, improving road connections to Brazil and constructing highway and later railroad bridges across the Río Uruguay to Argentina.

The highway network radiated out from Montevideo and in 1989 consisted of about 50,000 kilometers of roads, including 6,500 kilometers of the national network that received improvements during the 1985-89 period. Rural areas were served by a secondary network of 3,000 kilometers of gravel roads and 40,200 kilometers of dirt roads. Road transport carried an estimated 87 percent of all freight, and a modern bus system provided passenger links between most of the populated areas. Bridges at Fray Bentos and Paysandú spanned the Río Uruguay and provided for easy road transit to Argentina, and by the late 1980s newly paved roads to the northern border tied into the Brazilian road network (see fig. 8). In 1989 Uruguay was granted loans of US\$84 million from the Inter-American Development Bank and US\$81 million from the World



Figure 8. Transportation System, 1990

Bank (see Glossary) to modernize its international highways and to begin construction of Route 1, linking Montevideo with Buenos Aires.

Owing to the high cost of automobile ownership in Uruguay, traffic congestion in Montevideo remained low by the standards of other cities in the world. There was no subway system in 1990, but an extensive bus network operated on a twenty-four-hour basis. The city's electric trolleys had been allowed to decay, and the number of routes had been repeatedly reduced.

In 1989 the government-owned AFE maintained 3,000 kilometers of standard-gauge railroads. Montevideo was the center of the system with lines extending out to the north, northwest, and east. Three connections with the Brazilian rail system and a new link with Argentina that opened in 1982 allowed for easier shipment of goods to these countries. The rail authority, however, found it increasingly difficult to maintain passenger trains in the face of a decade of declining ridership. In 1988 all passenger service was discontinued under the government's five-year rationalization program designed to downsize the stagnant railroad subsector.

Carrasco International Airport, located twenty-one kilometers from Montevideo, was the country's principal airport. Capitán Curbelo Airport, near Punta del Este, also handled international flights to Brazil and Argentina. Fourteen other primarily commercial airports with paved runways were distributed throughout Uruguay. Uruguayan National Airlines (Primeras Líneas Uruguayas de Navegación Aérea—PLUNA) operated fourteen aircraft to domestic destinations and neighboring countries. Three Boeing 737s and one Boeing 707 were the workhorses of PLUNA's regional service. Uruguayan Military Air Transport (Transportes Aéreos Militares Uruguayos—TAMU), a small airline owned by the Uruguayan Air Force, maintained commercial flights on several domestic and foreign routes.

Despite improvements in land and air transportation since the 1960s, most foreign trade still went by water. Montevideo was the country's principal port, handling close to 60 percent of all cargo in the early 1980s. Other major ports included Colonia and Punta del Este on the Río de la Plata Estuary and Fray Bentos, Paysandú, and Salto on the Río Uruguay. Passenger ferries linked Montevideo and Buenos Aires with six-hour-long crossings via Colonia, and a modern high-speed hydrofoil traveled from Colonia to Buenos Aires in three and one-half hours.

River transport remained an important means of transportation, carrying about 5 percent of all freight, and the country counted over 1,600 kilometers of navigable inland waterways. The Río

Uruguay was by far the most important waterway, and ocean-going ships of up to 4.2 meters draught could travel north as far as Paysandú. Smaller vessels of up to 2.7 meters draught could travel upstream to Salto.

Broadcast facilities were numerous, and all parts of the country could receive at least one AM radio station or one television station. In 1990 there were ninety-nine AM stations, a quarter of which were in the Montevideo area. Ten of the AM stations broadcast on shortwave frequencies to reach a larger audience both domestically and abroad. All stations, except for one government-owned transmitter, were commercial, and broadcasts were in Spanish. Montevideo had four television stations; another twenty-two were scattered in towns across the country. Uruguayans had an estimated 1.8 million radio receivers and 650,000 television sets in 1990.

Improvement of the nation's telephone system was a priority for the Sanguinetti government. By 1990 there were over 345,000 telephones (at least 11 percent of the population, the highest per capita in South America), an increase of over 25 percent from five years earlier. The US\$13 million expansion of service, about half of which took place in the country's interior, helped reduce the number of households and businesses on a waiting list for telephone service. The government's monopolistic communications agency, ANTEL, planned to invest US\$100 million in the telephone system between 1989 and 1993, extending service to another 180,000 households in the country's interior. The basic elements of the nation's telecommunications network were expanded, and the system was modernized. In 1990 the government heeded the growing Latin American trend toward privatization of state enterprises when it began allowing private investment in the nation's telephone system. After years of depending on Argentine relay stations for its international telephone service, Uruguay installed its first satellite earth station in 1985. In 1990 it had two International Telecommunications Satellite Organization (Intelsat) earth stations. Telex and facsimile (fax) services were also expanded.

Tourism

Tourism in Uruguay generated an estimated US\$300 million in 1989, equivalent to 22 percent of merchandise exports. The tourist industry depended mainly on visitors from Argentina. Thus, not only were tourist receipts seasonal (peaking in the warm summer months, January through March), they also fluctuated along with economic conditions in Argentina and relative exchange rates. In 1989 about 85 percent of the 1 million tourists were from Argentina; an additional 10 percent were from Brazil, and smaller

*Artigas Boulevard,
a highway leading
to downtown Montevideo
Courtesy Inter-American
Development Bank*



percentages came from Paraguay and Chile. Many of the visitors from Argentina owned property in Uruguay, especially in the resort area of Punta del Este, which drew half of all summer tourists.

In 1986 the Sanguinetti government created the Ministry of Tourism to regulate hotel and resort prices and to promote Uruguayan tourist attractions at international exhibitions. The ministry also developed programs aimed at attracting visitors and conventions to Uruguay during the low season, but with limited success. At the same time, the government supported the improvement of hotels, marinas, and camping facilities. To protect the beaches, a key tourist attraction, the Montevideo sewage system was being upgraded in 1990 so that it would discharge more than two kilometers offshore. Despite such efforts, tourism was expected to remain mostly regional because of the long distance from Europe and the United States, lack of services (Uruguay had no five-star hotels), lack of promotion, and restrictive transportation policies (for example, charter flights were difficult to get).

External Sector

Two concerns dominated Uruguay's foreign economic relations during the 1980s. The first, both a fiscal and an external problem, was the foreign debt. Uruguay's external debt of about US\$6.7 billion (US\$6.2 of this was foreign debt to the United States) in 1989 (US\$4.2 billion belonging to the public sector) was not an

issue affecting international financial markets, like the much larger debt burdens of Brazil or Mexico (each over US\$100 billion). Even so, Uruguay's indebtedness was onerous in comparison with the size of its economy and was one of the highest per capita debts in the region. For both the Sanguinetti and the Lacalle governments, debt reduction and debt rescheduling were priorities.

The second major concern was trade, primarily for its importance to overall economic growth. Trade-related activities were responsible for about 12 percent of GDP in 1988. Exports, which were the source of Uruguay's wealth in the early twentieth century, were seen as the key to the revival of the economy. Demand within Uruguay was simply too small to support large production increases. Trade was especially important in the 1980s because of the debt burden. In order to make payments on mostly dollar-denominated loans, Uruguay needed foreign exchange (dollars). Thus, the trade balance (the difference in value between exports and imports) took on added significance. To spur economic growth and to earn foreign exchange, Uruguay joined other Latin American nations in restraining imports and augmenting exports. Despite its positive trade balance, however, Uruguay's foreign debt continued to increase.

Foreign Debt

Uruguay began borrowing abroad on a large scale in the 1970s after the price of oil (its largest import) quadrupled. The oil price increase that prompted many developing nations to begin borrowing also made it easier for them to borrow; commercial banks were flush with petrodollars (foreign exchange obtained by petroleum-exporting countries through sales abroad) and were eager to make loans. Uruguay's debt increased from US\$500 million in 1976 to as much as US\$5.9 billion by the end of 1987. Although this debt was already large in proportion to Uruguay's GDP, international financial conditions made the loans appear beneficial for both the creditors (commercial banks and international organizations) and the Uruguayan government.

The most significant positive trend, from the point of view of both parties, was the decline in the late 1970s of the dollar's value, relative to major currencies. This decline meant that dollar prices of most internationally traded goods were rising, a fact that had double significance. First, Uruguayan exporters (like exporters in many other developing countries) were earning more dollars for a given basket of goods, making the country appear capable of repaying a large debt. Second, real interest rates (the nominal interest rate minus inflation) were negative. That is, the rate at which

the dollar value of Uruguay's exports was rising (about 30 percent per year in 1979) was higher than the nominal United States interest rate (11 percent per year in 1979). Thus, it was becoming easier for Uruguay to service its external debt. Under these conditions, the government was inclined to continue borrowing abroad to finance its deficit and to fund development projects.

The situation changed dramatically in the 1980s for several reasons. First, the dollar appreciated significantly. This reversed the process that had occurred in the 1970s; the dollar price of Uruguay's exports fell. Second, the United States tightened its money supply. This prompted banks to raise interest rates on both old and new loans (the adjustable interest rate had become common in the 1970s). Both of these developments raised the real interest rate on Uruguay's debt. As the dollar appreciated, the peso declined, making the dollar value of Uruguay's GDP smaller and the ratio of debt to GDP larger (with both debt and GDP denominated in dollars). At the same time, lower export earnings made it more difficult for Uruguay to service its external debt. New loans were needed just so that the country could service old debt, even though foreign borrowing had become far less attractive than in the 1970s. In 1985 the total debt burden stood at US\$4.9 billion; debt service (interest payments alone) consumed 34 percent of the nation's export income.

The debt crisis overshadowed all other economic difficulties in Uruguay during the late 1980s. The crisis was a vicious circle. Paying off the debt required higher growth and higher income. But the mere act of paying debt service on the huge amounts of principal reduced essential investment spending and precluded sustained economic growth. While the debt continued to grow, finding the means of servicing the debt became an economic priority; Uruguay was one of the few Latin American countries that did not default on its debt. While debt service became difficult, new external loans were no longer available (except to help service old debt) because Latin American debtors were no longer considered creditworthy. Thus, the government had to resort to inflationary means ("printing money") to finance its public-sector deficit domestically. This directly contradicted the government's primary goal of eliminating inflation.

The Sanguinetti administration's debt policy focused on the most immediate difficulty for Uruguay: large debt-service payments. Through negotiations with its creditors, including the International Monetary Fund (IMF—see Glossary), the government was able to gain some breathing space. The debt-service burden declined to an estimated US\$449 million in 1989 (28 percent of export

earnings) from US\$613 million in 1988 (44 percent of export earnings). However, the fact that debt was merely being rescheduled meant that the overall debt burden did not decrease. New financing actually added to the debt, which increased to US\$6.7 billion by the end of 1989. Several projects to reduce the debt principal were carried out under the debt-for-equity program, but they were small compared with the total debt. During the 1988-89 period, the Central Bank approved fourteen investment projects that reduced the debt by an estimated US\$78 million.

Substantive efforts to decrease a portion of the debt burden—the US\$1.7 billion owed to commercial banks—began in March 1989 in the context of the United States government's Brady Plan. In an important departure from earlier United States policy, the Brady Plan (named after Secretary of the Treasury Nicolas Brady) officially recognized the need for debt reduction. Minister of Economy and Finance Ricardo Zerbino and Central Bank president Ricardo Pascale began debt negotiations with international creditors in September 1989.

The Brady Plan offered commercial banks holding Uruguayan debt three options. (The same three options applied in the case of other Latin American nations, with minor variations in the percentage terms of each option.) First, the banks could increase their current loans by 20 percent over four years, offering Uruguay new money in exchange for strengthened guarantees of repayment. Second, banks could exchange their debt for guaranteed bonds (backed by United States Treasury bonds) paying a fixed 6.34 percent interest. Finally, banks could opt to allow Uruguay to repurchase its debt for 56 percent of the debt's face value. In a tentative agreement reached in 1990, banks holding 28 percent of the debt chose the new money, banks with 33 percent of the debt chose to convert to fixed-interest bonds, and those holding the remaining 39 percent chose to allow Uruguay to repurchase its debt. The agreement was significant even though it affected only about one-fourth of Uruguay's debt. As the *Economist* reported, "Once a country has reached a Brady-plan deal, it is on the road to financial respectability."

Trade

Uruguay expanded its involvement in international trade considerably during the latter part of the 1980s. Exports doubled (in nominal dollar terms) from US\$854 million in 1985 to US\$1.6 billion in 1989. Imports increased at a slower rate, from US\$675 million in 1985 to US\$1.1 billion in 1989. The merchandise balance of trade reached a positive US\$463 million in 1989, helping to offset the demands of debt service.

The largest export markets were Brazil (US\$443 million in 1989), the European Community (US\$363 million), the United States (US\$177 million), and Argentina (US\$78 million). Brazil (US\$369 million), Argentina (US\$177 million), and the United States (US\$109 million) were the leading sources of imports in 1988. Uruguay's largest exports continued to be its so-called traditional products: wool (US\$288 million in 1989), meat (US\$225 million), and hides (US\$129 million). While much attention continued to be focused on these three largest exports, a variety of nontraditional exports took on growing importance during the late 1980s. Goods such as processed foods, grains, fishery products, chemicals, and finished leather apparel together accounted for 60 percent of Uruguay's exports by the end of the decade.

Uruguay's largest import was crude oil. Imports of oil declined during much of the 1980s as Uruguay increased its reliance on hydroelectric power. Reduced oil prices in the late 1980s, combined with the reduction in the quantity of imports, helped improve the nation's overall trade balance. The value of oil imports declined from US\$433 million in 1982 (40 percent of imports) to about US\$120 million in 1988 (about 10 percent of imports). In 1989 the trend toward lower oil imports was reversed when the severe drought compromised Uruguay's capacity to generate hydroelectric power; oil imports increased to US\$139 million. As a nation with no domestic sources of petroleum, Uruguay was particularly hard-hit by the oil price rise that accompanied the Persian Gulf crisis in late 1990. Domestic fuel prices were raised by over 50 percent during September and October 1990.

Several categories of industrial imports increased as Uruguay's manufacturing sector recovered from the recession. The largest increases were among semi-industrialized products, such as chemicals, rubber, and plastics, which increased from US\$300 million in 1982 to US\$500 million in 1987. Imports of capital goods (machinery and transportation equipment) dipped in the mid-1980s but recovered to US\$150 million in 1987, indicating that manufacturing activity could increase. In 1989, however, imports of capital goods fell by 14 percent to US\$137 million.

Balance of Payments

Uruguay's trade balance was positive and steadily improving during most of the 1980s. However, the current account balance remained negative until the mid-1980s because of the burden of debt service (see table 16, Appendix). In 1986, 1988, and 1989, the trade balance was large enough to make the current account balance positive. An exception to this pattern was 1987 because

imports surged as the economy recovered from the recession. The capital account balance was positive for most of the 1980s because Uruguay continued to borrow from abroad to help cover its debt-service payments and because foreigners continued to deposit money in Uruguayan banks. Uruguay's reserves decreased during most years, but as of 1988 the nation still had substantial gold reserves—more than 80 tons. During the 1989 presidential campaign, at least one candidate proposed selling the gold reserves to pay off the foreign debt. Lacalle opposed such a plan, however.

Economic Integration

Economic integration with other Latin American nations was an important goal for Uruguay because of its small internal market. The idea of integration was enshrined in the nation's constitution, which states that "the Republic will seek to achieve social and economic integration of the Latin American nations, especially to provide for a common defense of products and raw materials."

Sanguinetti played an important mediating role in the early discussions of integration between Argentina and Brazil, a delicate process because of the traditional rivalry between the two larger nations (see Foreign Relations under Democratic Rule, 1985–90, ch. 4). Presidents Raúl Alfonsín of Argentina, José Sarney Costa of Brazil, and Sanguinetti held five trilateral meetings between 1986 and 1988, during which they signed several tariff-reduction agreements and discussed a long-term framework for regional economic integration.

The Uruguayan government predicted that the lower trade barriers would allow Uruguayan exports to Brazil and Argentina to increase by 80 to 90 percent by 1991. In practice, however, Uruguay's trade with its larger neighbors seemed to be affected more by exchange rates than by tariff and quota agreements. For example, Uruguay already had bilateral trade agreements with both Brazil and Argentina during the late 1980s, but in early 1990 exports to Argentina covered by the agreement actually declined. In contrast, exports to Brazil increased markedly during the first half of 1990 after the Brazilian government tightened liquidity and caused the Brazilian cruzeiro to appreciate.

Despite such early evidence that the trade agreements were having only a limited effect on regional commerce, Lacalle indicated in early 1990 that he expected Uruguay to continue to play a pivotal role in regional integration. He indicated further that he hoped the integration would be extended to include Paraguay and Bolivia. "We will try to open the Atlantic balcony to [those] inland countries," he said, "improving the operation of our ports, promoting

the use of the Paraná-Paraguay waterway, and establishing free-trade zones near the ports for the manufacture of products from the South American 'hinterland'." Lacalle also said he proposed to President Andrés Rodríguez Pedotti of Paraguay the formation of a trinational fleet of merchant vessels to carry Uruguayan, Paraguayan, and Bolivian products to markets in North America, Europe, and Asia.

Thus, Lacalle envisioned Uruguay not only as a participant in trade agreements with its larger neighbors but also as a close partner with the smaller and apparently more stable economies of the region. A noteworthy aspect of Lacalle's plan was its stress on the development of the regional infrastructure. Lack of such an infrastructure—there was no railroad bridge between Uruguay and Argentina, for example, until the Salto Grande Dam opened in 1982—remained a serious impediment to regional integration.

Free-Trade Zones

The free-trade zones that Lacalle mentioned were already operating in Uruguay during the late 1980s as an important part of the Sanguinetti administration's strategy to encourage both foreign investment and regional trade. Under legislation passed in late 1987, free-trade zones such as the ones in Colonia and Nueva Palmira (in Colonia Department) became attractive sites for investors for several reasons: users were exempted from all Uruguayan taxes, except for social security taxes on Uruguayan workers; all imported goods and services entering the zones were exempt from customs duties or taxes; goods and services reexported from the zones were exempt from taxes; and commercial or government service monopolies were not applicable within the zones, so that no company was forced to deal with the State Insurance Bank, for example. Restrictions on free-trade zones prohibited companies from duplicating existing industries, such as textile manufacturing. Thus, the thrust of the program was to attract innovative companies to Uruguay. As of early 1990, the free-trade zones were attracting a good deal of attention, but it was too soon to tell what impact they would have on the Uruguayan economy.

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A superb and very readable introduction to Latin American economic history, with references to Uruguay, is Celso Furtado's *Economic Development of Latin America*, which focuses on major themes such as import-substitution industrialization. For a more detailed picture of Uruguay's economic history until the 1970s, the best

Uruguay: A Country Study

English-language source is M.H.J. Finch's *A Political Economy of Uruguay since 1870*. Few English-language books have focused exclusively on Uruguay's more recent economic progress. A good source in Spanish is *La Crisis uruguaya y el problema nacional* by the Centro de Investigaciones Económicas.

Several references examine individual aspects of Uruguay's economy. Two good articles on the labor movement are Arturo S. Bronstein's "The Evolution of Labour Relations in Uruguay" and Juan Rial Roade's "Uruguay." Larry A. Sjaastad's "Debt, Depression, and Real Rates of Interest in Latin America" explains Uruguay's early involvement in the debt crisis.

Basic economic data on Uruguay are provided in the International Monetary Fund's *International Financial Statistics*, in the Inter-American Development Bank's *Economic and Social Progress in Latin America*, published annually, and in the *Latin American Regional Reports* series of periodicals. Two useful Uruguayan economic periodicals are *Guía financiera* and *Búsqueda*. (For further information and complete citations, see Bibliography.)