

Uruguay

Status Index (Democracy: 9.90 / Market economy: 7.43) 8.66		Management Index 6.85	
HDI	0.840	Population	3.4 mn
GDP per capita (\$, PPP)	8.280	Population growth¹	0.7 %
Unemployment rate	N/A	Women in Parliament	10.8 %
UN Education Index	0.94	Poverty	<2
		Gini Index	44.6 (2000)
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003.			

A. Executive summary

Uruguay is an exceptional case in Latin America. It has had a long tradition of strong participatory and party democracy throughout the 20th century, and since the 1930s it has built one of the first modern (almost European) bureaucratic welfare states with a high level of distribution based on high revenues from agricultural exports. The decline of the export-driven economy in the late 1960s and early 1970s produced a crisis of the Uruguayan model of democracy, which subsequently led to military rule (1973-85). Since the early 1990s, Uruguay has again enjoyed consolidated democracy under the rule of law without any substantial defects, with a strong civil society and a high level of participation. It has no stateness problems, the institutions are stable, and all political actors follow the rules of the democratic game. Legitimacy and institutional stability have been considerably improved by the electoral reforms of 1996, which reduced fragmentation and gave the government a stronger mandate to lead. There is no political extremism or violence.

During the two years under review here (2003-2005), the level of consolidation of democracy has not changed significantly. Political and social integration have even been slightly improved by the party realignment that took place in the elections of October 2004. Those elections gave the broad center-left opposition coalition formed around the Frente Amplio (EP-FA-NM) a clear mandate to govern and also an unprecedented majority in parliament. Presidential candidate Tabaré Vázquez (who was to take office in March 2005) received more than half of the popular vote in the first round, whereas in 1999 he had only received a third of the votes. In that election, the two traditional parties of the establishment, the Colorados and the Blancos, joined forces in the run-off against the “newcomer” and managed to install Colorado veteran Jorge Batlle in the presidency (2000-2005).

The Batlle government (from which the Blancos resigned in 2002) presided over Uruguay’s worst recession and financial crisis of the last century. After a low

point in 2002, Batlle managed to win substantial new loans and renegotiate the country's international debt in 2003. But his administration lost clout, energy and imagination from then on, increasingly polarizing political and social forces and ending in parliamentary gridlock and isolation. Whereas the last two years of the Batlle administration have been lost years for Uruguayan politics, the balance of Batlle's entire term is rather mixed. In some areas there have been improvements – most of them incremental and contained – in economic crisis management, in the war on corruption, in addressing human rights issues and in the work of the Peace Commission. In other areas, for example in the war on poverty, in the implementation of administrative, judicial and tax reforms, in reforming education and the systems of social security and welfare, there have been no improvements.

Uruguay's economic transformation has been more protracted. Its principal problems consisted in the need first, to modernize and diversify a traditional, dependent and crisis-ridden agricultural export economy; second, to deregulate the strong public sector and contain heavy state interference in the economy; and third, to reform the comprehensive but no longer affordable or effective systems of the welfare state. In addition, poverty and social exclusion have worsened. These problems are relatively new and are a product of recession and too many neo-liberal experiments since the military regime. Despite many obstacles and limitations, some progress has been made since the 1980s, particularly in increasing non-traditional exports (though not sufficiently), deregulating state enterprises, containing inflation and restoring growth. Still, by the end of the 1990s, Uruguay was drawn into the financial crises of its larger neighbors and did not recover before 2003.

Since 2001, Uruguay's economic development has been a mixed experience with both a deep recession and significant recovery within a short period of time. The recession was at its worst in 2001 – 2002 when the threat of default loomed. But by 2003, international assistance and comprehensive debt renegotiation led to a significant recovery and postponed the most pressing problems until after 2005. Relative stability has been restored, inflation has been brought under control, rising growth is back and exports have gone up significantly.

The country's average level of development has improved slightly. Many strategic indicators, however, point to containment or stagnation. Little progress is evident in domestic and foreign investment, expenditure for education, research and development, tax revenue, the account balance, unemployment and informality. Poverty persists, as does the structural budget deficit and high levels of debt, which have even increased recently and have made the country more dependent on continuous assistance from the international financial community. Other characteristics include dependence on the performance of Uruguay's neighbors, lack of attraction for foreign investors, insufficient diversification of non-traditional exports and the vulnerability to natural disasters, diseases and price fluctuations on the world markets. A potential for further growth exists,

particularly in diversified exports, tourism and services, but Uruguay remains highly dependent on transnational context and foreign investment.

The quality of political management and governance in Uruguay since 2003 has, on average, not been too exciting. The quality of the ruling government's management and governance has been much lower than before, especially after the new loans and the debt moratorium had been successfully negotiated and the confidence of international donors restored. This particularly affected and reduced the potential for administrative, fiscal, structural and social reforms. In short, the government's leadership ability was weak. For the opposition, the reverse was true: the Frente Amplio and its leaders, including presidential candidate Tabaré Vázquez, left their sub-cultural and class limitations behind, built a broad catch-all coalition at the elite and the mass level, presented a carefully drafted moderate, realistic and attractive program, succeeded in communicating it to the people, and managed to win the elections in the first round. This was political craftsmanship at its best. Such skills will be needed after the new government has taken office to keep confidence in Uruguay alive, to design pragmatic and effective reform legislation consistent with the country's needs and priorities, to satisfy international financial institutions and not disappoint the expectations of the voters.

B. History and characteristics of transformation

Since the Batllista reforms (inspired by the various presidencies of José Batlle y Ordóñez of the Colorado Party) between 1900 and 1930, Uruguay has been a stable democracy throughout most of the 20th century. It has an active and strong civil society (mostly of immigrants of European descent) characterized by affluence and significant distributive policies. These policies turned a small, homogeneous and highly urbanized country into one of the first modern welfare states and a development model of its own in Latin America. The basis of Uruguay's prosperity was a boom in agricultural (basically cattle) exports that lasted uninterrupted until the mid-1950s. This boom triggered industrialization and modernization and promoted social integration, but it left the country highly dependent on the world markets for its traditional (almost monocultural) export products.

One of the principal characteristics of the Uruguayan model was the early institutionalization of a peculiar system of competitive party democracy rooted in all segments of society and channeled through the two traditional parties, the Blancos (Partido Nacional) and Colorados with their various factions, lists and "sublemas." The system combined a high degree of mobilized, participatory factionalism with mechanisms of integration and reform. This managed to satisfy the needs for decision-making and institution-building until the late 1960s. The democratic consensus was strong, social homogeneity high and the state (and the

city of Montevideo) fulfilled major functions as providers of collective goods and services. Significant national, ethnic, religious or social cleavages were nonexistent with the exception of the classic industrial divisions between capital and labor.

The crisis of the Uruguayan model began when, after the decline of export prices for cattle in the 1950s, the potential for distributive policies shrank and an increasingly unimaginative and unreconstructed political class was no longer able to respond to the new political challenges, to promote economic diversification or to fight social deprivation. Instead, the established politicians, under the pressures of protests organized by the left and an insurgent urban guerrilla movement, gradually handed power over to the military and a few associated technocrats between 1967 and 1973.

The bureaucratic-authoritarian regime of the military in Uruguay lasted from 1973 to 1985. Quantitatively and qualitatively, the military regime was more repressive and did more damage to Uruguayan society, human capital and the elites than did the military regimes in Argentina or Chile. It was unable to solve any of the country's pressing problems, ended in failure and decline, and was followed by a transitional government (1985-89) that had been negotiated between the military "softliners" and the moderates of the opposition during summer 1984. This produced a gradual transfer of power back to civilian politicians. At first the military tried to exclude some of their most fervent opponents, including the moderate leftist Broad Front (Frente Amplio) and the Blancos, led by Wilson Ferreira Aldunate, but they soon lost control and the dynamics of the democratic process took over. Since the early 1990s, democracy in Uruguay has consolidated. The first period of re-democratization was characterized by processes of restoration: the constitution of 1967 was restored as was the civil service and the complicated electoral and party system with all its limitations on clear mandates and legitimacy. These limitations were not reformed until 1996. The necessary reforms of state structure, public administration, the welfare state and the large public sector came were postponed.

Institutional democratization was achieved by broad consensus and cooperation, partly because President Julio María Sanguinetti (1985–1989) of the Colorado Party, whose faction had not collaborated with the military, could not command a majority in parliament. Most military officers retained their military posts. After three years of intense debate, the crucial problem of addressing the human rights violations committed by the military during the dictatorship was solved in a way that was acceptable to the military by a statute of limitations written into law and approved by a clear majority in a referendum in 1989. The historical and moral problems involved had to be taken care of later.

Since then, there have been four successful democratic transfers of power. The first, in 1990, put the Blancos' candidate, Luis Alberto Lacalle (1990–1995), in

power. The second election, in 1995, returned Sanguinetti (1995–2000). The third installed Jorge Batlle (2000–2005) in the presidency. A traditional Colorado politician, though from a different faction, Batlle enjoyed broader legitimacy because of the changes to the electoral system. It was not until March 2005 that the first “non-traditional” (though experienced) candidate could assume the highest post: Tabaré Vázquez of the Frente Amplio, Batlle’s strongest contender in 1999, won the elections of October 2004 with an unprecedented majority in the first round.

While the transition to democracy in Uruguay was completed in less than a decade, the transformation of the economy, which began under military rule, was more protracted. Here the problems centered around the need first, to modernize and diversify a traditional, dependent and crisis-ridden agricultural export economy; second, to deregulate the large public sector and contain heavy state interference in the market; and third, to reform the comprehensive but no longer affordable or effective systems of social provision of the once opulent Uruguayan welfare state. At the same time, a new phenomenon had to be fought: growing misery and rapid impoverishment, which had been accelerated by military repression and by too many neo-liberal experiments. The country had witnessed, for example, a 50% loss in real wages between 1970 and 1983.

Despite stagflation, a high rate of capital flight and growing external debt, and despite the fact that Uruguay’s economic transformation has been slowed by the country’s corporatist traditions of seeking consensus, moderate and incremental solutions, and limited risk, significant progress has been made since the 1980s. Non-traditional exports were increased, debts periodically renegotiated and energy prices fell. In addition, many state-owned or state-controlled enterprises (*entes autónomos*) have been deregulated or privatized in spite of strong resistance, voiced in referenda in 1992 and in December 2003. During most of the 1990s, the economic growth rates oscillated around 5%, and inflation and unemployment were both contained to about 10%. Overall, however, the trend has not been turned around convincingly. In addition, by the end of the 1990s, the terms of trade and the account balance deteriorated dramatically. Uruguay was drawn into the financial crises of its larger neighbors and it did not recover, at least in a number of sectors, before 2003.

C. Assessment

1. Democracy

Since the early 1990s, democracy based on the rule of law has been consolidated in Uruguay and is embedded in a strong civil society with established channels of participation. There are no significant deficiencies in crucial areas. The severe

economic and social problems the country currently faces have not affected or delayed the successful return to democracy. The reforms of the electoral system instituted in 1996 removed the initial weaknesses of a reduced institutional efficiency and legitimacy. Furthermore, the Batlle and Vázquez administrations have addressed the historical and moral dimensions of the crimes of the previous military regime.

1.1. Stateness

Uruguay has no stateness problems. The state has the monopoly on the use of force, There is fundamental agreement about who qualifies as a citizen. All citizens have the same civil rights, and there is a fundamental acknowledgment of the constitution. The state is defined on secular terms. Religious dogmas have no influence on politics or law, and there is separation of the church and state. Administrative structures are well established in Uruguay. They are functional throughout the country and are capable of implementing political decisions and allocating resources. The administrative system is sufficiently efficient, though in some areas there is some need for reform.

1.2. Political participation

Rulers are determined by general, free and fair elections. There is effective universal suffrage, and elections are carried out appropriately. The democratically elected rulers have the effective power to govern; there are no veto powers or political enclaves. There is unrestricted freedom of association and of assembly within the basic democratic order. Citizens, organizations and the mass media are able to express their opinions freely and without restrictions. Uruguay's Freedom House ranking has been 1.1, "free", since 2000. The media are pluralistic. The press is privately owned, and some newspapers are associated with political parties. During the period of authoritarian rule in Uruguay, the size and variety of high quality party political press declined, and some newspapers were forced to close down when tax exemptions on the import of newsprint were suspended in 1996. Radio and TV are both commercial and public.

1.3. Rule of law

There is a functioning system of checks and balances. The legislature, executive and judiciary operate independently of each other and mutually respect the other's area of competence. There is, however, a traditional tendency and often-institutional pressure for government and parliament to find consensus. Government actions are subject to parliamentary and judicial review, and scandals are usually uncovered. The judiciary is traditionally independent, free from

unconstitutional influence, differentiated and professional, although it does suffer from lack of efficiency, particularly against street violence and organized crime. The continued presence of some officials appointed by the authoritarian regime also cast a shadow over the judiciary.

As a rule, corrupt officeholders are severely prosecuted under established laws. Anti-corruption measures have been strengthened by the passage of anti-drug legislation and the 1998 Transparency Law (*Ley Cristal*), which created a Financial Investigations Unit, criminalized a broad range of abuses of power by officeholders (including money laundering), and made financial disclosure statements compulsory for many officials. In March 2003, the president of the association of public attorneys (1999-2001) was brought to trial for corruption, demonstrating the effectiveness of the laws. According to the Corruption Perceptions Index of Transparency International, corruption in Uruguay is among the lowest in Latin America and has decreased even further in recent years. The CPI, which indicates the degree of perceived honesty, improved from 4.3 in 1998 to 5.1 in 2001 and 2002, 5.5 in 2003, and 6.2 in 2004. Uruguay moved up from rank 34 in 2003 to rank 28 in 2004.

There are currently no restrictions on civil rights and human rights. However, the efforts of the government to address the human rights violations of the former military regime seem to have dwindled somewhat in recent years. For example, the Peace Commission (*Comisión por la Paz*) – created in 2000 by President Batlle in order to investigate all open cases of those who had “disappeared” during the dictatorship – issued a report in April 2003 addressing only 24 cases, far fewer than had previously been discussed in public. Although the report had left many other cases open, the government issued a decree stating that the investigation was closed and that the remaining cases involved technical details like financial compensation or were covered by statutes of limitation.

Attempts were also made over the past year to limit the rights of due process for members of the military involved past human rights violations (in favor of “special” trials) and to grant immunity based on limitation *ex ante*. This provoked loud protests among organizations representing the relatives of the “disappeared” and human rights activists who insisted that the government fulfill its legal obligations under Article 4 of the 1989 Limitations Act, calling for clarification of the fate of the registered “desaparecidos”. While this contributed to a significant decline in the president’s popularity, the Supreme Court opened an inquiry in August 2003 against former President Bordaberry (1971-76) on charges of violating the constitution.

1.4. Stability of democratic institutions

Democratic institutions in Uruguay work effectively and efficiently. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities. The institutions are also accepted and supported by the relevant actors. There are neither significant semi-loyal or disloyal actors nor forces with veto powers, and there is no indication of any putsch ambitions on the part of the military.

1.5. Political and social integration

The Uruguayan party system is moderate and relatively stable. The conservative and liberal parties, the Colorados and the Blancos, as well as their various factions and elites (often elite families), have more than a century of tradition in the country. The system has also been capable of integrating a substantial newcomer: the moderate leftist Frente Amplio coalition (FA, later EP-FA) consistently achieved around 20% of the vote beginning in the early 1970s through the late 1980s. It has successfully governed the city of Montevideo since 1990, improved its share of the electorate in the middle of the 1990s (earning 31% of the vote in 1994), and it has become the strongest political force of the country since 1999.

The integration into the political system of the former representatives of the excluded or marginalized classes, of radicals and of ex-guerrilleros has been one of the greatest pacifying achievements of the transformation of Uruguay. In December 2002, the EP-FA concluded an alliance with the smaller leftist liberal Nuevo Espacio (NE), led by Senator Michelini. The alliance had traditionally been dominated by communists, Christian Democrats and ex-Tupamaros in the 1970s and 1980s, and later by socialists (like Tabaré Vázquez). Today, it is a broad catchall coalition, adding to its ranks moderate social democrats, liberals, human rights activists and even prominent representatives of the influential agricultural interest group Federación Rural, which had previously been a stronghold of the Blancos.

The level of fragmentation is low if political parties and not their traditional factions (*listas*) are considered. Volatility is also generally low barring any major swing in voting because of deep disappointment in the incumbents and a great difference between the perceptions of the candidates and programs instituted, as was the case in the elections of October 2004.

In these elections, President Batlle's Colorados lost more than 20% compared to the elections of 1999, whereas the opposition Frente Amplio and the Blancos (who had left the coalition government a year before) each gained more than 12%. The results of the 2004 elections have produced a significant realignment and changed the Uruguayan party system: While before 2004, the Colorados, the Blancos and the Frente Amplio each commanded about one third of the vote, now

the broadened Frente Amplio coalition represents about one-half of the electorate, leaving the other traditional parties to split the other half. The popularity of the Colorados has reached a historical low point. Political alternatives have become clearer and more cleavages are visible.

The electoral reforms of 1996 brought about a major improvement to the system. These reforms have been decisive in streamlining the party system, reducing fragmentation, and broadening the legitimacy of the president. In the old system, voters cast their votes for the presidential candidates of the various factions within the parties, and the ticket with the highest plurality of votes within the party took it all. This usually meant that elected presidents rarely mustered more than 15% or 20% of the total vote. The 1996 reforms introduced primaries and a run-off election between the two leading contenders (ballotage), effectively creating more stable majorities and strengthening the mandate of the government.

The reforms cost frontrunner Tabaré Vázquez of the Frente Amplio the victory in the first presidential elections conducted under the new rules in 1999. Most Blanco voters supported Colorado veteran Batlle in the final run-off after their own candidate had been eliminated in the primary. In the end, Batlle received 51.6% of total votes while Vázquez received only 44.0%. The triumph of the Frente finally came in the 2004 elections because of severe “desencanto” over the disappointing record of the Batlle government. Colorado candidate Guillermo Stirling came in last (10.4%) behind the Blanco candidate Jorge Larrañaga (34.3%). Tabaré Vázquez, backed by a broad coalition (EP-FA-NM), made it to the presidency in the first round of voting, receiving 50.4% of the votes. The Frente coalition also won absolute majorities (also a new phenomenon) in both houses of the parliament, performing strongly in not only in Montevideo, but also in the interior of the country.

Uruguay has a long history of interest representation, organization and pressure group formation as well as of defining the legal framework, the rules and the mechanisms of interest mediation. There is a closely-knit network of differentiated interest groups that are fundamentally cooperative, reflect competing economic and social interests, and tend to balance one another. They also have close ties to the political parties and the relevant bureaucracies. Interest groups include the farmers’ Federación Rural, a number of industrial and business associations, particularly the Cámara de Industrias del Uruguay (CIU), influential professional associations, as well as strong and well organized labor unions, coordinated by the Convención Nacional de Trabajadores (CNT, now PIT-CNT) since 1964. Many of these interest groups have long traditions and are closely related to the early emergence of the Uruguayan welfare state, which is itself now in crisis.

Support for democracy in Uruguay is the highest in Latin America, has a long tradition, and does not depend on the performance of the government as it does in

many other Latin American countries. Support for democracy has remained high even during periods of discontent and party realignment. According to Latinobarómetro data, support for democracy has fallen from 84% in 2000 to 78% in 2002 and in 2004, parallel to the decline in satisfaction with democracy (69%, 52%, and 45%, respectively). The potential for authoritarianism has receded in crises (9%, 10%, 7%), and only 33% in 2004 said that they would not mind having a non-democratic government if it solved the economic problems. Seventy-one percent insisted that voting made a difference for the future of the country, and 84% saw democracy as the only system conducive to development. Democracy in Uruguay is secure and consolidated with regard to its attitudinal dimensions.

Uruguay has a strong civil society, which forms the backbone of its traditional democracy. Civil society played an active role in the resistance against military rule (thus forcing the military to resort to extraordinary rates of repression) and in the relatively smooth transition to, and consolidation of, democracy. There is a closely-knit web of autonomous, self-organized groups, associations and organizations, including well organized protest groups campaigning against the human rights violations committed by the military regime or in contemporary prisons, or against misadministration of justice. There are also groups campaigning on behalf of tens of thousands of citizens who have fallen victim to the processes of economic and social deregulation and restructuring of recent decades, or who have sunk into poverty and now live in the growing slums around Montevideo. Interpersonal trust, however, has fallen significantly since 2002, from 36% in 2002 to 24% in 2004. Nevertheless, it is still among the highest in Latin America.

2. Market economy

Uruguay's economic transformation has made some progress since the mid-1980s, and particularly during the 1990s. However, progress has remained limited, is dependent on international markets and on the performance of the country's bigger neighbors Brazil and Argentina, and has not yet found a sustainable new basis. In addition, since the late 1990s, the country has been affected by the regional financial and debt crisis (particularly evident in Argentina), which was intensified by inappropriate domestic measures and inadequate crisis management. By 2002, Uruguay found itself in the midst of its deepest recession of the 20th century from which it did not begin to recover until 2003. Uruguay's economic performance between 2003 and 2005 is of particular interest.

2.1. Level of socioeconomic development

Uruguay is not a typical third world country. The indicators reflect a decades-long structural decline from earlier first world prosperity with all its legacies including a level of development that is relatively high within the Latin American context, a more balanced income distribution, low regional disparities, and a solid, if technically antiquated and often obsolete, infrastructure. In principle, the country's level of development permits adequate freedom of choice for all citizens, and no significant parts of the population are fundamentally excluded from society because of poverty, gender, education, religion or ethnicity.

The HDI has improved from 0.803 in 1990 and 0.816 in 1995 to 0.833 in 2002. The GDI in 2002 (0.829) ranks higher than the HDI (rank 41 as opposed to 46). The UN Education Index stands at 0.94, and literacy rates are estimated at between 98% and 100%. Although the extent of poverty is still limited in comparison to other countries, it has become a bigger problem in Uruguay particularly since the recession of the late 1990s and early 2000s. Poverty is now increasingly structurally ingrained in Uruguay. The absolute poverty ratio is below 2, but almost 4% of the population lives on less than \$2 a day. The Gini coefficient indicates that there was an increase in inequality between 1999 and 2002, from 42.3 to 44.6.

2.2. Organization of the market and competition

The fundamental elements of a market economy and free competition are in place. Uruguay is by tradition an economically liberal country with corresponding institutions and guarantees, including those for the banking system, the capital market and foreign trade. One of the legacies of the 20th century, however, has been an entrenched tradition of economic state activities and state interventionism in a number of sectors, primarily infrastructure, energy and services, in order to promote development and to secure the guarantees of the welfare state. Hence, rules have not always been consistent or uniform for all market participants. The process of deregulation, decentralization and privatization of state-owned or state-controlled enterprises began under the dictatorship. This process has continued, albeit at slow pace due to a lack of attraction for potential investors, financial crises, as well as the reluctance of politicians and voters. In a 2003 initiative and a subsequent referendum held in December 2003, 62% of voters rejected a 2002 law permitting a joint venture of the state-owned fuel, alcohol, and cement corporation ANCAP with a transnational company. In October 2004, almost two-thirds (64.6%) insisted that marketing of the country's water resources be barred by the constitution, and a majority voted into power a political party that had campaigned against excessive privatization.

There is legislation regulating monopolies and oligopolies, but it is not completely consistent as it leaves loopholes open and does not address the public and public/private sector. Foreign trade has been liberalized, though there are still a number of fiscal import restrictions. Though not a member of the G-20, Uruguay has been active in fighting United States and European Union restrictions of agricultural trade. The country is a member of the Mercosur (serving in the presidency in 2003) and it has contributed to a number of efforts to enlarge and further integrate free trade zones in Latin America in recent years.

Due to its location, political stability and liberal capitalist traditions, Uruguay has long been one of the principal financial centers of Latin America. It has been particularly attractive for foreign capital and bank deposits from its neighbors, where taxes are generally higher and there are tighter controls. The banking system and capital market are differentiated, internationally competitive and oriented toward international standards, but they are vulnerable to severe fluctuations owing to extreme dependence on outside factors, a general lack of supervision, and widespread fraud and corruption.

During the fiscal, debt, currency and banking crises of 2001 and 2002, the Uruguayan central bank and other authorities were not able to sufficiently fulfill their supervisory functions, thus reducing their potential and credibility. In 2002, the growing recession, default and devaluation in Argentina brought the financial system in Uruguay to near collapse: a run on Argentine accounts in Uruguayan banks, withdrawals en masse, organized fraud (which ruined a big commercial bank), a spectacular reduction of foreign exchange in bank accounts and of almost all of the currency reserves, and a resulting liquidity crisis placed major stress on the system. Uruguay lost its investment grade status on Wall Street, had to float and devalue the peso, declare a week-long bank holiday, put four bankrupt commercial banks under state control (and later closed them), cope with banking strikes and looting, and temporarily freeze fixed dollar accounts in order to be able to re-open businesses with intense IMF and U.S. assistance. As a regional banking center, Uruguay has been saved but at the cost of dramatically increased foreign debt.

2.3. Currency and price stability

The government and the central bank, whose formal independence does not leave much room for maneuver under certain circumstances, work together to keep inflation under control and to pursue appropriate exchange rate policies. However, the institutional framework is not adequate and these goals cannot be pursued consistently over the long term because of Uruguay's extreme dependence on foreign influence and volatility. In years of economic stability, Uruguay's achievements have been impressive. During the 1990s, the currency was stable and the annual rate of inflation decreased considerably to around 5% in 2000 and

2001. The recession, the subsequent loss of monetary reserves and the deep monetary, fiscal and banking crisis of 2002, however, triggered a sharp devaluation of the peso against the dollar by almost 60%, followed by an additional loss of 30% in 2003. Inflation reached a new height of almost 26%. The country slowly began to recover by mid-2003 after new international credits had been awarded and foreign debts had once more been renegotiated. The rate of inflation has fallen to 10% and 8% in 2003 and 2004, respectively.

In fiscal and debt policy, Uruguay has pursued a policy of macroeconomic stability. This has been demonstrated throughout the last two decades in a series of efforts to increase tax revenues, the repeated adoption of austerity measures and cuts in public expenditure, particularly for social services. Economic contraction, lack of investment and rising unemployment has contributed to an increase in poverty. The institutional safeguards have, however, been limited and the country was once again been drawn into the regional crisis so that it has not been able to significantly reduce its budget deficit. Because of the latest crisis, the deficit has increased from 3.5% of GDP in 2000 to between 4.5 and 5% from 2001 to 2003.

In 2002 and 2003, insolvency and default were only avoided though new credits the Batlle government was able to mobilize thanks to its good relations with the United States (for which it had to pay by suspending its diplomatic relations with Cuba) and international financial institutions. These credits were successively granted and released in short sequence, often as stand-by, and amounted to a total of about \$4 billion. Despite the fact that rating agencies downgraded the country several times over two years (leading to higher interests), Uruguay has, by comparison, been treated rather generously by donors. Donors seem to have had more confidence in the Batlle government than the citizens of Uruguay had, and often made it explicit that the country was not to be held directly responsible for its acute financial problems. Foreign debt has consequently grown from \$8.2 billion in 2000 to over \$10.5 billion in late 2003, roughly equal to about 100% of the GDP. Because devaluation had made servicing the increased debt nearly impossible and default was near, a complicated deal was struck with donors in spring 2003 to reschedule the conditions of repayment. The Batlle government succeeded in buying time and leaving the problems to the successor government, due to take office in March 2005. The risk of populist policy changes was rather low, as Batlle seemed to have preferred being unpopular than populist. It is not yet clear, however, whether this will also apply to the Vázquez government.

2.4. Private property

Uruguay has a liberal capitalist tradition, and so property rights and rules regulating the acquisition, benefits, use and sale of property are well defined and generally safeguarded. Within the context of the latest financial crisis, there have

been some problems with implementation of the rules, particularly with regard to a temporary freeze of foreign exchange bank accounts. However, such measures have thus far remained short-term and are not as drastic as those measures adopted in Argentina. Despite being pressured by the IMF, President Batlle explicitly refused to implement such drastic measures in the interest of preserving political order.

The economy is dominated by private enterprises, and privatization of state enterprises has made continuous progress since the 1980s, including the sale of the state airline PLUNA in 2002. However, there is still a large state sector as privatization has slowed down during recent years. The slow pace of privatization will likely continue because of the referenda of 2003 and 2004 and as the programs of the Frente Amplio and the Vázquez governments have indicated. Some initial steps by the Vázquez government in March 2005 (Petrosur, Telesur) suggest that it may be prepared to follow the Brazilian model and form multinational public/private ventures.

2.5. Welfare regime

Uruguay's traditional welfare state is based along the lines of the European model. The problem, however, is that the Uruguayan government has not been able to fulfill its welfare obligations and the claims of the insured have been devalued. Like all traditional systems of social provision, the Uruguayan system needs comprehensive reform and restructuring, particularly in view of demographic stagnation. Uruguay has the oldest society in Latin America and rising rates of emigration of younger people, significant unemployment of around 15%, and an extended informal sector of an estimated 40% of the labor force (2003) place pressures on the welfare state. The social security, unemployment and health insurance systems all must be reformed, and substantial cuts must be made in the early retirement, pensions and benefit schemes of an overstuffed and privileged civil service and military.

Reforms have been initiated but they have thus far lacked creativity and decisiveness. Social security has been partly privatized, public health costs have been reduced and many benefits have been cut, but the system still requires major restructuring. Most of the budget of the Banco de Previsión Social still goes into pension and unemployment benefits, and it must be increasingly subsidized by the state because the contributions of the insured have receded in times of high unemployment. Another problem is the rise of poverty, accelerated by the crisis of 2001-2003. In late 2002, about 50,000 of the poorest citizens had to be fed by the state on a daily basis (INDA), and the UNDP estimates that about one-quarter of Uruguay's pregnant women and 13% of children younger five years suffer from malnutrition. The new Vázquez government launched an emergency plan against poverty in March 2005 (Plan de Atención Nacional de Emergencia Social),

focusing particularly on food, health, and family benefits for the unemployed and poor, and on education in problem areas. Based on a model adopted in the United States state of Wisconsin, the plan makes use of available resources, particularly in the health sector, and combines the traditional mechanisms of unemployment insurance and welfare benefits for the needy with new requirements for those able to work. The additional costs have been calculated at around \$100 million.

Equality of opportunity exists in principle, although this has been deteriorating for some time and the share of marginality and poverty has reached a critical limit. There are a number of institutions, both traditional and new, to compensate for gross social differences, and the new government's emergency program plans to intensify existing activities. Women have equal access to education and public office. The female rates as a percent of the male rates in adult and youth literacy in 2002 were 101; the ratio of female to male enrollment in primary, secondary and tertiary education in 2000 and 2001 were 1.01, 1.11 and 1.82.

2.6. Economic performance

Uruguay's economy is far from stable. Its performance is at best mediocre and is often negatively affected by its extreme dependence on foreign influences and markets. This dependence can bring the country to the brink of collapse, as was the case in 2002. Whereas growth can be reinstated and other macroeconomic data can be contained or improved in good times, Uruguay's greatest structural problem is the high level of debt, which has been rising in recent years and has made the country even more dependent on continuous assistance from the international financial community. Other characteristics are the dependence on the performance of Uruguay's neighbors, lack of appeal for foreign investors, lack of diversified non-traditional exports and vulnerability to the consequences of monocultural production such as natural disasters and diseases (e.g., Foot and Mouth Disease or BSE) or even falling prices.

Uruguay has recovered from the crisis of 2003. GDP per capita growth, which had been stagnant throughout most of the 1990s and had fallen to -11.5% in 2002, increased by about 2% in 2003. Growth for 2004 has been estimated at between 8 and 11%. Exports have substantially recovered, but so have imports, and the account balance has not improved. Inflation has once again been contained: after rising from 3.6% in 2001 to 26% in 2002, it has fallen to around 10% in 2003 and 8% in 2004. Unemployment shows a similar trend: after a dramatic rise to 20% in 2002 and 2003, the rate of unemployment appears to have receded back to 13% in 2004. Uruguay's Central Bank declared that the recession ended in September 2003. However, the level of debt increased, state budget deficits continued, real wages in 2003 fell by about a quarter, and 20% of medium and small businesses were reported to have declared bankruptcy during and after the crisis of 2002 and 2003. For 2004, a primary surplus (before interest payments) of 3.4% of the GDP

and a private investment of 12% of the GDP has been targeted; the IMF intends to raise these targets to 4% and 20% within five years. The potential for further growth undoubtedly exists, particularly in diversified exports, tourism and services, but this remains highly dependent on context and foreign investment. Even under ideal conditions, and despite the new government's program for a "Uruguay productivo", it will be difficult to address Uruguay's entrenched structural economic problems.

2.7. Sustainability

Ecologically compatible growth has been taken into account in important sectors of economic life. Environmental concerns are effectively addressed in many sectors that depend on the environment, for example, in modern stockbreeding, wine production and tourism. Overall, ecological concerns tend to be subordinate to efforts to promote growth, which still is considered the principal economic goal. Rural emigration, increased poverty and expanding slum settlements around Montevideo have also limited the chances for a better environment. The reluctance and resistance to modernize a number of key state enterprises in the energy sector through public/private partnership also limited environmental efforts.

Modern infrastructure exists in principle, but needs updating. Uruguay has a solid and differentiated system of primary and secondary education, but it has suffered from budget cuts, lack of discipline and reduced efficiency in recent years. According to an official report from October 2003, the number of effective classroom hours of secondary students in Uruguay is 50% to 65% lower than in comparable schools in Spain, France or Great Britain. Due to its lack of sufficiently professionalized M.A. and Ph.D. programs in many areas, the traditional and still overwhelmingly public tertiary sector is not yet internationally competitive and lacks sufficient funding. This is particularly true for institutions of advanced studies, research and development, where the effects of the scientific "brain drain", further worsened by the military regime, are still being felt. New curricula, individual reforms and a debate on the needs and shape of educational reform have brought about some modernization over the last few years, and competition among private universities has begun. According to the UNDP, public expenditure on education between 1999 and 2001 was lower than the period 1995-1997 or in 1990 (2.5%, 3.3% and 3.0% of GDP, respectively).

3. Management

3.1. Level of difficulty

Overall, the structural constraints on governance are moderate in Uruguay, particularly in comparison to the rest of Latin America. The country is small, homogeneous, and Western, is rich in agricultural resources, has a long institutional and societal tradition of democracy, and has a socially responsible market economy. There are no stateness problems, the level of education is relatively high, and civil society is strong. The only structural constraints result from the country's small size, its severe losses of human capital under military rule, its extreme dependence on foreign capital and markets, and on the economic performance of its larger neighbors. Its high level of debt also makes Uruguay dependent upon the United States and international financial institutions. Consequently, the room for maneuver has been narrow and especially narrow during the country's worst recession and financial crisis in 2002-2003 and its aftermath.

Uruguay has a strong, differentiated and institutionalized tradition of civil society and a developed participatory civic culture, both of which have been conducive to democracy and long periods of social peace. However, trust in institutions and social trust have suffered a bit lately due to the perceived processes of rapid downward mobility, marginalization and impoverishment, even among segments of the middle classes, because of dictatorship, neo-liberal reforms, unemployment and economic and financial crises. There are no significant ethnic and religious cleavages or conflicts, although social cleavages and conflicts have been increasing since economic decline began under military rule. This has led to a more clearly marked division between the (still) established society, represented by the Colorado and the Blanco Parties, and the marginalized or lower classes, represented by the Frente Amplio coalition. The cleavages are, however, in no way irreconcilable. Overcoming these cleavages depends on economic and political performance.

Profile of the Political System

Regime type:	<i>Democracy</i>	Constraints to executive authority:	3
System of government:	<i>Presidential</i>	Electoral system disproportionality:	8.8
		Latest parliamentary election:	31.10.2004
		Effective number of parties:	2.4
1. Head of State:	<i>Jorge Batlle Ibáñez</i>	Cabinet duration:	03/00-03/05
Head of government:	<i>Jorge Batlle Ibáñez</i>	Parties in government:	2
Type of government:	<i>divided government</i>		
2. Head of State:	<i>Tabaré Vázquez</i>	Cabinet duration:	03/05- present
Head of government:	<i>Tabaré Vázquez</i>		
Type of government:	<i>unified government</i>		
		Number of ministries:	12
		Number of ministers:	12
Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i ; p_i is the share of parliamentary mandates controlled by party i . For presidential/semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties reflects the political weight of parties (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i . Number of ministries/ ministers denotes the situation on 1 January 2005.			

3.2. Steering capability

During the period under review, the political leadership has been committed to constitutional democracy and a socially responsible market economy. On the whole, their policies have given these goals priority over short-term expediency, despite the vicissitudes of crisis, debt renegotiations and popular agitation, all of which narrows the room for choice considerably. This has not precluded disputes over different policy alternatives with regard to the ways and means to reach these goals, particularly between the center-right government of the Colorados and the leftist opposition around the Frente Amplio and the unions. Disputes have also arisen between the government and some of the Blancos who had left the government in late 2002 and steered a somewhat unclear course in the year before the 2004 elections. President Batlle followed his course of stability, austerity, budget and debt consolidation, administrative reform, privatization and economic restructuring even at the risk of gridlock and losing support. In May 2003 his popularity was down to only 12%, a low from which he barely recovered for the rest of his term. Opposition leader Vázquez, who was considered by most to be the likely next president, stuck to his priorities in favor of more social responsibility, a war on poverty, and a more active role of the state in promoting national industry, including Keynesian-like programs. He also named moderate Senator Danilo Astori, one of Uruguay's brightest economists and a reformer, critical of the EP-FA for its inability to compromise, as his minister of finance and economy.

In 2003 and 2004, the Batlle government had only limited success in implementing its reform agenda. Most of its legislation was either blocked in parliament, where the government lacked a majority, was strongly criticized in public or was dramatically rejected in a well-organized referendum. This was in contrast to the year 2002 when, despite all financial and fiscal crisis management, several substantial packages of budget consolidation had been written into law, including cuts in military and diplomatic expenditure, a tax increase on higher incomes, a value added tax on fruits, vegetables and flowers, and higher prices for fuel, international telephone calls, water and electricity. After the tide of recession and crisis had turned and the debt problem had been settled by mid 2003, the actors seemed exhausted. Much of the remaining term of the Batlle administration seemed to be a lost period. Administrative reforms stagnated or were counterproductive, plans for constitutional reform (including regionalization and introduction of a prime minister) were stymied, finance and economics minister Atchugarry, one of the last hopes of the Colorados, resigned after a year in office in August 2003, and social reforms came to a standstill as elections approached. Even in foreign policy the Batlle government appeared isolated because of its close alliance with the Bush administration.

Up to a point, the leading political actors have been capable of learning and acting flexibly, but to different degrees: The EP-FA leadership learned the most, which secured electoral victory in the end. They continued to attack from the left the increasingly immobile government, consolidated their alliance with the liberal and social democratic NE and the associations of agriculture and industry, incorporated economically reformist candidates and positions into their ranks, and finally drafted an attractive moderate and market-conscious but socially responsible program similar that of the Lula government in Brazil. The Blancos also learned when they left the government and voiced positions closer to those of the EP-FA or the earlier Colorado governments under Sanguinetti. Nevertheless, they were not able to find common ground or a sufficient profile. The least was learned by the Batlle government during the two years under review here. It only learned where its limitations lay, whether in parliament, in public, or in the polls. It displayed no imagination or energy in integrating the various forces, shaping a new consensus or staging a comeback to lead politics and policies.

3.3. Resource efficiency

The government's use of the available economic and human resources has not been very efficient. The balance is rather mixed. Efforts to extend tax revenues substantially and introduce a broad based income tax, which had been advocated by the IMF, have not been successful. The budget deficit and the debt are relatively high, although transparency of the budget has been improved, as has auditing (SEV) and controlling (SIIF) in some areas of public administration. Particularly lacking are controls and regulation of public administration, some of

which has been outsourced and privatized – often to the same personnel at better salaries. Despite a general moratorium on hiring new public servants announced by Sanguinetti and upheld by Batlle, public administration is still overstaffed and personnel costs are too high. In many areas permanent civil service posts have been abolished, often replaced by short-term employees (“asesores”) who, with the exception of the treasury and fiscal administrations, have been hired to do the work through generally opaque and closed competitions. Most of the new “asesores” are as “clientele-istic” as most of the previous civil servants were. The quality, efficiency and effectiveness of public administration has improved only in a few sectors. Decentralization figured in Batlle’s priorities for 2002, but this plan was not implemented. The reform of the state service sector (particularly in the health sector) and of state enterprises (entes autónomos) continues to be a chronic problem.

Comprehensive reform of public administration (Reforma del Estado), which was first launched by Sanguinetti in 1995 and developed a substantial bureaucracy of its own, made only limited progress in 2003 and 2004. Gridlock, abuse, and even waste have characterized this effort. Often the results have been counterproductive, and the necessary steering capabilities have been reduced instead of increased. Well-intended professionalization programs and recruitment systems stalled, fashionable concepts of “New Public Management” – inspired by the ideas of business administration – were applied out of context, and private profits at the expense of public expenditure were not contained. Most of the problems were left to the new government of Tabaré Vázquez in 2005, which has at least taken steps to rectify these mistakes by hiring the best-prepared and most outspoken critics of the failures so far of Uruguayan administrative reform.

Between 2003 and 2005, the Batlle government often failed to successfully coordinate conflicting interests and objectives. Presidential leadership and capability to promote integration were weak, there were frictions within the cabinet and between different executive agencies, frequent resignations and redundancies as well as counterproductive effects in policy interactions. In addition, rivalries between the various factions of the governing Colorado Party, particularly between Batlle and Sanguinetti, and gridlock between the executive and parliament hindered development of a coherent policy. In the period under review, the government continued to fight and successfully curb corruption. Most of the traditional and new integrity mechanisms function well; scandals have been reported. This, however, does not apply to the phenomena of more institutionalized corruption. Uruguay’s CPI has increased from 5.1 in 2002 to 5.5 in 2003 (rank 34) and to 6.2 in 2004 (rank 28).

3.4. Consensus-building

All significant political actors in Uruguay have agreed since 1985 to build and expand the country's market-based democracy. In fact, the high capacity for consensus building has been a particular asset of the Uruguayan political system and civil society for about a century. Its traditional democracy has always tended to be a consensus or consociational democracy with a number of corporatist arrangements. Moderation, compromise, and the search for consensus on (often incremental) reformist projects have characterized the course of traditional Uruguayan politics. Most presidents have appointed members of various parties and factions, including from opposition parties, to cabinet or other high office posts. The integration of the left, represented by the new Frente Amplio, into this broad reformist consensus has been one of the major achievements of Uruguay's transformation since the 1980s, though it did take some time. Neither the more accentuated marginalization and social polarization that has taken place in society over the last few decades and particularly since the latest financial crisis nor the subsequent party realignment before and during the 2004 elections have substantially affected this basic consensus. When the Batlle government, inspired by neo-liberal ideas or suggestions from the IMF, eventually tried to break out of the established consensus, for example by pursuing plans to privatize basic services and energy, cutting back benefits in the social and health sector or introducing drastic changes in taxation, a consensus-minded political society either ignored the proposals or voted them down.

There are no significant anti-democratic veto actors in Uruguay, and reformers can usually co-opt most of their democratic competitors pursuing slightly different strategies and priorities. The political leadership generally succeeds in managing political cleavages, preventing escalation into irreconcilable conflicts. On the one hand, the Colorado government was not able to contribute much to reducing existing social divisions and avoiding more marked political polarization and party realignment. On the other hand, the opposition Frente Amplio has done extremely well in moderating its demands and program, broadening its coalition, addressing the dangers of polarization and building bridges. Consequently, the balance has been mixed between the various groups.

In Uruguay, social capital has been so widespread and deeply entrenched in civil society, interest associations, and the political parties and factions that neither repressive military rule nor weak or inconsistent democratic leadership have been able to substantially damage it. There is not much need for the political leadership to promote and develop it further because it is already present to a sufficient extent. Political leadership in Uruguay typically assigns a key role to civil society actors in deliberating and determining policies. During the two years under review here, President Batlle unsuccessfully deviated from this practice, often against the objections of his cabinet. The Frente and many Blancos, on the other hand, engaged civil society and in the end, profited from this exchange. The division

between the different factions of political leadership regarding the problems of reconciliation between the victims and the perpetrators of human rights violations by the military regime in the past appears similar. Overall, justice has not been obstructed although full reconciliation has not yet been achieved. Some of the final problems have been left for the incoming Vázquez government to deal with.

3.5. International cooperation

Uruguay is a small, highly dependent, impoverished and indebted country prone to risk that is compelled to cooperate with international financial institutions and bilateral donors. There is broad consensus on this issue among the political elite although there may be slight differences in approach. Some factions of the EP-FA may eventually criticize globalization, neo-liberalism, or United States or IMF “dictatorship”. Uruguayan political leadership has made well-focused use of international assistance to address the needs of the country’s economic and structural transformation, for its domestic policy agenda, infrastructure and educational programs, to fight poverty and promote research and development. Between 2003 and 2005, the government was generally considered credible and reliable by the international community.

This reliability was demonstrated during the course of negotiating and implementing the comprehensive multilateral debt regulation, loan and support programs of 2002 to 2004, although it is true that the country was temporarily downgraded by the risk rating agencies. In contrast to Argentina, Uruguay has avoided default and bankruptcy and insisted on renegotiating its debts in time. Particularly good were the Batlle government’s relations with the U.S. government, despite domestic criticism of those relations. Uruguay supported the Bush administration’s unilateral international moves, broke off relations with Cuba, engaged in bilateral agreements and it was offered considerable military aid in 2003. In addition, the relationship with Argentina – which had been seriously damaged in mid-2002 by President Batlle’s characterization of Argentines as “a bunch of crooks” – have normalized. Coordination between the two countries improved between 2003 and 2005, and a number of joint projects with Argentina and Brazil are under way.

Uruguay’s political leadership has continually demonstrated that it is willing to cooperate with neighboring countries in regional and international organizations. It has actively and successfully built and expanded as many cooperative international relationships as possible and has promoted regional and international integration. Uruguay is a reliable member of the Mercosur, and it has contributed to its organization and infrastructure, promoting free trade agreements with Mexico, Peru and the Andean Community. Uruguay also supported plans for a Latin American customs union, better currency coordination, and greater openness, usually in alliance with Brazil.

4. Trend of development

4.1. Democratic development

Overall, stateness, political participation and the rule of law have remained at their former levels of quality. Uruguay has been a consolidated democracy under the rule of law without any substantial defects from the early 1990s onward; this did not change during the Batlle presidency. The rates of participation have continued to be extraordinarily high. Neither the most severe financial crisis of the past century nor a significant party realignment brought about by the elections of 2004 have destabilized the political system. These elections have once more demonstrated how much the country has benefited from the 1996 electoral reforms, which made democracy more efficient, increased democratic legitimacy and widened the room for action of the government. The wisdom of the voters in 2004 has even gone a step further than in 1999 and given the government a majority in parliament. Democracy works in Uruguay. In other areas there has also been improvement since 2002, most of them incremental, for example in fighting corruption, promoting transparency, protecting human rights and raising awareness of the need for state and administrative reforms. In other areas there was less progress, as in the implementation of administrative and judicial reforms, tax, education and social service reform, and parliamentary gridlock.

The level of consolidation of democracy, overall, has not changed significantly. It has not changed at all with regard to institutional stability. With regard to political and social integration, there even is a slightly positive trend in that the party realignment of the 2004 elections and its implications for more responsiveness and accountability has, for the time being, stopped the stagnation that dominated the Batlle administration.

4.2. Market economy development

Uruguay's overall economic development between 2001 and 2005 has been a rather mixed experience. Uruguay experienced a major and persistent recession combined with a structural financial crisis, a run on the banks and near default in 2001-2002, but beginning in 2003, restructured international assistance and debt renegotiation contributed to a significant economic recovery. The trend is clearly positive. Whether and how the country will be able to meet its accumulated financial obligations, however, is still an open question. Realistically, another round of debt renegotiations and new credit agreements may soon be required.

Table: Development of macroeconomic fundamentals (2000-2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	-1.9	-3.6	-12.7	3.0	12.0
Export Growth in %	5.2	-10.5	-18.8	14.7	28.9 P
Import Growth in %	4.9	-11.2	-33.8	9.8	35.9 P
Inflation in % (CPI)	5.1	3.6	25.9	10.2	8.2
Investment in % of GDP	14.0	13.8	11.5	13.1	13.8 P
Tax revenue in % of GDP	20.6	21.8	22.2	22.2	22.2
Unemployment in %	13.6	15.3	17.0	16.9	13.0
Budget deficit in % of GDP	-3.5	-4.5	-4.9	-4.6	-
Current account balance in billion \$	-	-	0.322	0.052	0.028

Source: IMF Country Reports Number 05/14, January 2005; CEPAL Preliminary Overview of the Economies of Latin America and the Caribbean 2004. Investment is Gross Domestic Investment; Unemployment is Urban Unemployment.

Uruguay's level of development, on the average, improved slightly, but not dramatically between 1995 and 2002, from 0.816 to 0.833 HDI. On the other hand, impoverishment, marginalization and exclusion significantly increased during the crisis, and it remains to be seen whether and when the economic recovery will trigger better indicators with regard to unemployment, social inequality and poverty. The overall institutional framework for market-based action has not changed significantly. Quantitatively, and particularly with regard to the figures of economic growth, there has been a great leap forward in Uruguayan economic development since 2003. The tide of recession has been turned, stability has been restored, inflation is under control, growth rates and exports have increased. Qualitatively, improvements have been more contained, and many fundamental strategic indicators point to slower movement or possibly stagnation in investment, research and development, tax revenue, employment, the account balance and the budget.

D. Strategic perspective

The perspective for market-based democracy in Uruguay in March 2005 looked much better than it did two years before. The acute economic crisis has been overcome, but policies to address many structural problems have been postponed. These structural problems, however, are due to reemerge soon. It is important to note that the confidence of international financial institutions and international donors, particularly in the United States and in Europe, did not dwindle during the

crisis and in fact was reassured and reconsolidated in 2003. Nevertheless, the Uruguayan political and economic leadership will have to continue to work hard to keep this confidence alive. The political order is stable and secure, its legitimacy, efficiency and capability to make decisions have been improved. In the elections of October 2004, the voters gave an unprecedented and clear mandate to the broad center-left coalition to implement an unusually explicit, moderate and somewhat social democratic reform program that gives priority to the wars on poverty, unemployment and corruption. The program also calls for a balanced budget, more tax equity, health care and education reform, infrastructural innovation and the promotion of competitive manufacturing industries, a more efficient state reform, decentralization and extended political participation.

Though there is much continuity with previous government programs introduced by the Colorados and the Blancos, all leftist dogmatism has been left behind. This particularly true regarding public-private joint ventures and on tax and welfare issues). Efforts have been made to combine and balance social responsibility with the incentives and potential dynamism of the market, including the prominence of the turn from “welfare” to “workfare.” The coalition and the Vázquez government have left no doubt that they will govern in a much different way than the past administration. The approach will not be a wholly neo-liberal one: deregulation and privatization will be implemented with common sense, and a number of minimum essentials will be preserved on the grounds of solidarity and compassion. This will be combined with reduced and market-compatible state interventionism. This approach not only corresponds with Uruguay’s strong legacy of compromise, consensus, and socially buffered “contained capitalism.” It also fits its present needs, improves social and political integration, and allows for stronger societal support for the measures that have to be taken.

In its first moves, the Vázquez government also demonstrated that it intends to be less deferential toward the United States than its predecessor, for example, by reestablishing relations with Cuba. It also intends to engage more in regional cooperation, be it multilaterally or bilaterally, with Brazil, Argentina, or Venezuela, through joint ventures, investing in breweries in Paysandú, through shares in Telesur or Petrosur, or oil for foodstuffs. Applications for new loans, renegotiating the international debt accrued by the Batlle government, and earning the confidence of and understanding of the World Bank, the IMF, the Inter-American Development Bank and the U.S. government will be as crucial as before. The Uruguayan government will have to continue walking a tightrope: Being economically weak and dependent as it is, it will have to compromise with donors on many socially and politically sensitive issues. This may soon begin to disappoint the high expectations of voters and produce the usual “desencanto” reformist governments must often face after several months in office. In the case of the new government of the EP-FA-NM coalition, expectations have been and

still are particularly high, especially in view of the coalition's leftist tradition and because it succeeds an administration generally perceived as having not "cared."

On the other hand, the Vázquez government seems to be better prepared to walk the tightrope than the Batlle administration. It has a stronger mandate, provides more decisive leadership, and the elites, parties and movements supporting it are more entrenched in contemporary Uruguayan society and considered closer to the people. As in the case of Lula in Brazil, there is also a sense of euphoria in the secular "new beginning" – which indeed it is for Uruguay. The government may be able to build on this euphoria, even in difficult times of austerity and sacrifice, and perhaps for a somewhat longer period than the previous governments could. In the end, however, the chances for substantial improvement will depend on the capability of the state and the government to deliver, and hence essentially on the performance of the economy. A first test will be provided by the outcome of the municipal elections in May 2005.