

# Development Challenges in Uruguay

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## Medium-Term Economic and Social Trends

The Uruguayan economy has posted 15 years of uninterrupted growth, with annual growth averaging 4.3% between 2003 and 2017. Growth rates were lower in 2015 and the first half of 2016, reflecting the plunge in commodity prices and difficulties in neighboring countries, but momentum resumed in mid-2016. On the supply side, this expansion—the longest in Uruguay history—has been driven by the strong performance of some agribusiness sectors, energized by major investments in forestry, as well as by the development of the service sector. On the demand side, the drivers have been consumption and investment; in the past five years, investment as a share of GDP averaged a historical high of 21%. Economic performance has been reflected in improvements in the main social indicators. The poverty rate fell from 33% in 2006 to 9% in 2016.

The macroeconomic framework is strong, providing stability that contributes to investment and productivity growth. After several years above the target band, inflation now hovers within the policy range targeted by the central bank (3%-7%); the headline rate in 2017 was 6.7%. The fiscal deficit (3.5% of GDP in 2017) is the main concern in the short term, and the government has already started implementing some consolidation measures. The country holds above-investment-grade sovereign ratings.

## Medium-Term Economic and Social Outlook

The outlook for upcoming years is strong. A key development will be the possible installation of the third paper pulp-processing plant in the country, the largest FDI project in Uruguay's history. GDP is expected to grow around 3% in 2018 and 2019, and inflation is expected to stay below the upper bound of the target range. The government aims at reducing the fiscal deficit to 2.5% of GDP by 2019.

## Risk Factors

The main risks to the outlook are related to external factors. Downside risks include a fall in commodities prices, lower growth in China and a reversal of the recoveries in Argentina and Brazil. Also, more restrictive global financial conditions could arise if the U.S. Federal Reserve Board accelerates its trajectory of interest rate hikes, dampening capital flows to emerging markets and increasing borrowing costs.

## Development Challenges

The main challenges to fostering long-run growth and sustainable development involve reducing significant and persistent inequalities, increasing human and physical capital stocks, promoting innovation and the use of new technologies, and fostering deeper trade integration with the rest of the world.



Human capital is one of the most significant constraints on economic growth. Uruguay has shortcomings in terms of the quality, relevance, and equity of secondary and technical-vocational education. Over 60% of young people fail to complete secondary school, and the supply of skilled labor in the workforce is insufficient.

In addition, there are costs associated with a significant infrastructure deficit and with difficulties in financing large infrastructure projects. According to the Global Competitiveness Index 2017-2018, which covers 137 economies, Uruguay is ranked 91<sup>st</sup> in overall infrastructure, 95<sup>th</sup> in quality of roads and 100<sup>th</sup> in quality of railroad infrastructure (World Economic Forum, 2017).

Another constraint on increasing productivity and competitiveness is the low level of investment in technology and innovation. Uruguay invests 0.4% of GDP in innovation, compared to Latin American and Caribbean regional rates and OECD rates of 0.7% and 2.5%, respectively. A comparison with successful small economies suggests that this figure is not sufficient to ensure sustainable productivity growth.

Uruguay also has a significant gap in its level of export diversification. Despite dynamic performance in recent years, Uruguay's exports continue to be concentrated in a few products that are vulnerable to fluctuations in international commodity prices and climate conditions. In 2017, 52% of goods exports corresponded to four products: beef, cellulose, soybeans, and dairy products. The country is making efforts to diversify its exports towards services as well as products with higher value added. In addition, the government has approved the First National Plan for Productive Transformation and Competitiveness, which seeks to stimulate the linkages between science, technology and innovation with productive development to improve Uruguay's insertion in the global economy.

## Conclusion

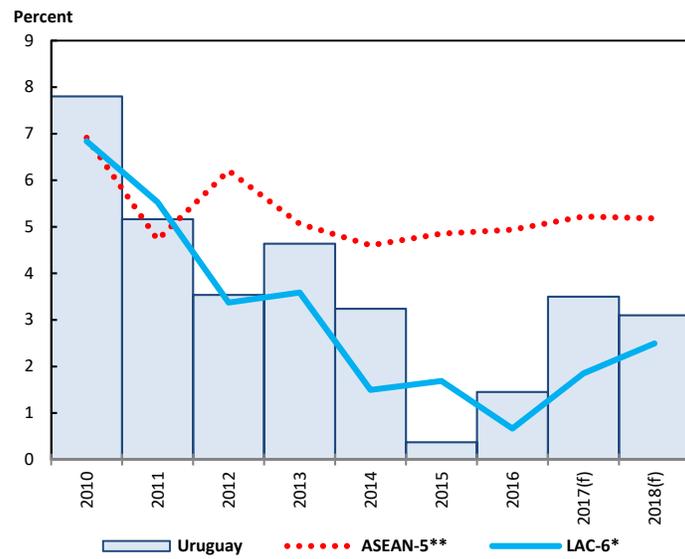
The country has many strengths which put it in a strong position to tackle these development challenges and boost growth in the coming years. Uruguay ranks among the top countries in Latin America (and is well positioned in the world) with regard to political stability and institutional soundness.<sup>1</sup> Moreover, Uruguay has one of the most developed information and communication technology (ICT) sectors in Latin America, outstanding in the region in terms of e-government, cybersecurity, ICT infrastructure and ICT exports per capita. These advantages, together with the country's solid macroeconomic framework, are strong assets to attract investment and provide the conditions for sustained growth.

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<sup>1</sup> Uruguay ranks number one in LAC in the Democracy Index (EIU, 2018), the Corruption Perceptions Index (Transparency International, 2017) and the Rule of Law Index (World Justice Project, 2018).



**Figure 1. GDP Growth**



Source: IMF (2017).

\*LAC-6 comprises Argentina, Brazil, Chile, Colombia, Mexico and Peru.

\*\*ASEAN-5 comprises Indonesia, Malaysia, Philippines, Thailand and Vietnam.



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