Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 15-May-2020 | Report No: PIDA29255

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Uruguay	P172796	UY - COVID-19 Response & Economic Recovery (P172796)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	18-Jun-2020	Environment, Natural Resources & the Blue Economy	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Oriental Republic of Uruguay	Ministry of Economy and Finance		

Proposed Development Objective(s)

The development objective of the proposed operation is to support the Government of Uruguay in (i) mitigating the economic and social impact of the COVID-19 outbreak and (ii) laying the foundations for a strong and resilient economic recovery.

Financing (in US$, Millions)

SUMMARY

Total Financing	400.00

DETAILS

Total World Bank Group Financing	400.00
World Bank Lending	400.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. **The COVID-19 outbreak is expected to push Uruguay's economy into a recession for the first time in two decades.** Over the past years, real GDP growth had been on a downward trend, declining from 4.6 percent in 2013 to 0.2 percent in 2019, the lowest level since 2002. Prior to the outbreak, it was expected that this trend would be reversed in 2020 as result of the implementation of the new Government's reform agenda as well as the prospect of large infrastructure investments associated with a paper mill project of historic proportions coming on stream. The economic fallout resulting from the COVID-19 outbreak has changed this scenario dramatically. Total exports contracted y-o-y by 10.9 percent[1] as early as February, due to a drastic drop in exports to China, Uruguay's largest trading partner. The domestic lockdown mandated in March then triggered a sharp decline in economic activity, affecting both demand and supply. Real GDP growth projections are nearly 6 percentage lower than they were at the beginning of 2020; they are projected to register at -3.7 percent, from an originally projected growth of 2.0 percent.

2. **The economic fallout will result in a significant increase in poverty and will generate an enormous strain for many Uruguayan families, with children and youth being particularly vulnerable to the shock.** Although the Government swiftly adopted emergency measures to mitigate the impact on the most vulnerable, building on existing social safety nets and adding temporary measures to expand the protection to those that do not qualify to existing programs, notably informal workers, Bank staff estimate that poverty will increase from 8.8 percent in 2019 to 11.8 percent in 2020, annihilating the major progress witnessed over the past decade. This is due to the economic impact of the pandemic layered over the effects of the drop in agricultural productivity from the drought as well as contagion from both Argentina's economic crisis and Brazil's recession. The increase in the poverty incidence translates into 106,000 additional people falling into poverty, disproportionately affecting households with children. Afro-descendants (1 in every 5 people in the poorest decile) and informal workers (7 in every 10 workers in the poorest decile) are disproportionately exposed to the shock. People in the bottom 40 percentile of the income distribution face higher risks of unemployment and labor income losses and make up a disproportionally large share of the workforce in the sectors most affected by the crisis, such as retail and hospitality. The expected increase in poverty incidence and severity threatens to erode human capital with lasting negative effects, and to raise concerns about perpetuation of disadvantages and social exclusion which stands in contrast to Uruguay's societal preference for equity and social cohesion.

3. **To spur a strong economic recovery, Uruguay will have to set the foundations for a robust growth trajectory, notably by strengthening policies and institutions to enhance resilience to different types of shocks.** The unprecedented economic shock caused by the COVID-19 outbreak is hitting Uruguay at the time of multiple risks pressing on the economy. First, Uruguay is confronting an increasingly adverse regional economic scenario, notably the protracted economic crisis and high market volatility in Argentina. Second, Uruguay is faced with a growing exposure to climate variability that is putting at risks major sectors of its economy, particularly agriculture. The different risk dimensions - health, fiscal and environmental - are mutually reinforcing and have the potential to create a "perfect storm" for the Uruguayan economy. The COVID-19 outbreak highlights the need for a more comprehensive and integrated approach to risk management, at the core of which is restoring prudent fiscal policy making. In order to put the economy back on a strong recovery path, the new authorities will need to embark on their ambitious medium-term reform program once the crisis abates, with a focus on the following dimensions: (i) fiscal consolidation, (ii) development of the private sector and (ii) resilience to climate and weather-related shocks.

[1] Although exports began to recover in March (in line with the rebound in industrial activity in China), they still were 23 percent lower than in March 2019.

Relationship to CPF

4. **The proposed operation is fully aligned with the 2016-20 Country Partnership Framework (CPF), and the 2018 PLR, notably as it supports Uruguay in "building resilience to shocks."** The 2015 Systematic Country Diagnostic (SCD) had identified the need to "build resilience to face economic volatility and extreme weather events" as one of the three main challenges for Uruguay. Accordingly, the first of the CPF's two Focus Areas is dedicated to "building resilience to shocks." This operation responds to the immediate needs to cushioning the impact of the pandemic on the most vulnerable workers and firms (Pillar 1) and lays the ground for a strong recovery (Pillar 2), through enhanced resilience to future shocks. The SCD update, currently under preparation, deepens the analysis of the vulnerability of the Uruguayan economy to multiple, reinforcing shocks (i.e. fiscal/financial, sanitary and environmental) and identifies key institutional weaknesses in this regard.

C. Proposed Development Objective(s)

5. The development objective of the proposed operation is to support the Government of Uruguay in (i) mitigating the economic and social impact of the COVID-19 outbreak and (ii) laying the foundations for a strong and resilient economic recovery.

Key Results

6. **Following corporate guidance on new IBRD financing for countries with an income above the Graduation Discussion Income (GDI), this operation addresses critical institutional shortcomings.** At the core of the operation are policy and institutional reforms that will lay the foundations for a strong and resilient economic recovery, notably through enhancing resilience to multiple shocks. It supports measures that aim at mitigating the economic shock caused by COVID-19, helping weather the impact on public finances, and restoring a robust fiscal outlook in the medium term. The operation thereby also contributes to safeguarding access to external capital markets on reasonable terms, an additional key feature of corporate guidance on GDI countries. This is critical given that the COVID-19 crisis has rendered access to sovereign financing more challenging for emerging economies, including Uruguay. Uruguay is currently rated just above the investment grade[2], with a negative outlook in recognition of its large fiscal consolidation needs in a time of economic downturn. In addition, through its objective of enhancing resilience of the economy against climate shocks, the operation supports the provision of regional and global public goods.

D. Project Description

7. **The proposed DPL is a stand-alone operation aimed at mitigating the economic and social impact of the COVID-19 outbreak and improving policies and institutions for a strong and resilient economic recovery.** The policy matrix of the operation includes key priorities in the Government's emergency response to the COVID-19 crisis and in the medium-term reform program. The first pillar is focused on supporting efforts to cushion the expected strong social and economic impact of the crisis, with a focus on the most vulnerable households and firms that would otherwise by financially viable. The second pillar is reflective is reflective of the ambitious medium-term reform commitments of the Government to support a strong and resilient economic recovery through: (i) instituting a fiscal policy framework that safeguards fiscal and debt sustainability, (ii) improving business climate for private sector development, (iii) enhancing disaster and environmental risk management and, (iv) transforming agricultural production towards higher resilience to climate change and increased productivity.

[2] Uruguay's sovereign credit rating, according to Fitch, is the lowest possible rating within the creditworthiness band, i.e., BBB- with a negative outlook. The other two major credit rating agencies place Uruguay at BBB.

8. The proposed DPF will support important reforms along two pillars:

- **Pillar 1 of this operation aims at supporting a series of temporary countercyclical measures to protect the most vulnerable and avoid the destruction of productive assets in the face of the COVID-19 pandemic.** These measures include: (i) the enactment of a series of countercyclical measures, including the creation of the COVID-19 Fund to swiftly respond to the sanitary crisis (PA#1), (ii) the strengthening of three important social assistance programs to (partially) offset temporary income losses of lower income groups (PA#2), (iii) the creation of a temporary unemployment insurance scheme to protect workers against effects of lay-offs or partial suspensions (PA#3), (iv) the strengthening of the institutional response to the expected rise of violence in the context of the COVID-19 quarantine (PA#4), and (v) the adoption of emergency measures to support access to finance for MSMEs (PA#5). In the presentation of these emergency measures, the Government emphasized their temporary and countercyclical nature and committed to rolling them back once the crisis will have passed.

- **Pillar 2 of this operation aims at laying the foundations for a strong and resilient economic recovery.** The COVID-19 outbreak brings to the fore how the deteriorating fiscal position over the past years has limited the scope of a countercyclical fiscal crisis response. The Government is committed to reversing the trend of rising fiscal deficits and debt levels by instituting a fiscal policy framework that safeguards fiscal and debt sustainability and allows for conducting countercyclical policies in times of economic downturns. This agenda is at the heart of the medium-term reform program, as reflected in the Urgent Reform Bill, and will be implemented in full once recovery sets in. The commitment to fiscal consolidation has already manifested itself by measures adopted soon after the Government started its mandate, such as the elimination of certain tax expenditures in VAT (as reflected under the PA#6). Pillar 2 also reflects the Government's commitment to continue advancing on structural reforms for private sector development and on institutional strengthening for better protection of the economy against climate-related shocks. Both agendas were initiated under the previous Government and have been endorsed by the current administration as critical foundations for a dynamic and sustainable recovery after the COVID-19 pandemic. The Government will pursue a broader reform effort aimed at improving Uruguay's regulatory environment, such as by easing requirements and costs for firm registration (PA#7). Uruguay also needs to strengthen its capacity to shelter its economy against climate variability to avoid jeopardizing its recovery post-COVID. Addressing disaster and environmental risks is by nature a complex and multi-sectoral endeavor, transmitting through various channels to the entire economy, and requires differentiated yet coordinated interventions at various levels of government. In this sense, the operation supports the institutional strengthening of the emergency response system, with enhanced coordination (both horizontal and vertical) between public and private stakeholders (PA#8) as well as the transformation of the agriculture model that increases resilience to climate variability, while enhancing productivity (PA#9).

E. Implementation

Institutional and Implementation Arrangements

9. **The Ministry of Economy and Finance (MEF) will be the main responsible agency for the monitoring, evaluation, and results framework and will coordinate actions across relevant ministries and agencies involved in the operation**. The agencies responsible for the implementation of the prior actions supported by the operation include: (i) Pillar 1: Ministry of Social Development (MIDES), Ministry of Labor and Social Security (MLSS), Ministry of Public Health (MPH), National Institute for Women (InMujeres) and MEF; (ii) Pillar 2: MEF, SINAE and Ministry of Livestock, Agriculture and Fisheries (MGAP). The World Bank will be monitoring the implementation of the DPF program through regular supervision missions. The World Bank will maintain close dialogue with counterparts throughout preparation and collaborate with MEF for the monitoring of indicators.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

10. **The policy measures supported by this DPF series are aimed at mitigating the short-term social and economic impact of the Covid-19 pandemic on the most vulnerable, while implementing structural reforms aiming at building enhanced resilience to multiple shocks (sanitary, fiscal and environmental).** As such, the overall reform package supported is expected to contribute to mitigating the effects of the pandemic shock on the poor, both directly through strengthening the social safety net, but also by facilitating a faster and more sustainable recovery. By strengthening the social protection systems, the policy program under the first pillar is expected to mitigate the impact of the Covid-19 shock on the most vulnerable by providing emergency relief as part of a time-bound countercyclical economic stimulus package. Policies supported under the second pillar of the operation are aimed at strengthening the foundations for a strong economic recovery with an emphasis placed on enhancing institutional capacities in reducing the country's exposure to future shocks, which tend to affect disproportionally the most vulnerable groups of the society.

Environmental, Forests, and Other Natural Resource Aspects

11. The policies supported under Pillar 1 of this DPL are not likely to cause significant negative effects on the environment, forests, or other natural resources. The policies supported under the second pillar of this operation aim at strengthening the foundations for private sector development and are expected to increase overall economic activity. Spurring economic recovery after the COVID-19 pandemic does not imply a relaxation of environmental standards, given the strong environmental management framework in Uruguay. The adoption of a policy on emergency and disaster risk management and institutional strengthening of the National Emergency System-SINAE (PA#8) is expected to reduce adverse impact to the environment including degradation of natural resources and the human urban environment from exposure to disease and effects of infrastructure loss. The adoption of the national plan of adaptation to climate variability and climate change (PA#9) is expected to have significant positive environmental effects.

12. **Uruguay has a strong legislative and regulatory framework and relatively effective public-sector environmental agencies.** The limited negative environmental effects that could result from the operation will be well managed and mitigated by the existing laws and regulations. Agencies such as the DINAMA and DINAGUA and DIGESA (under the Ministry of Health) provide oversight and regular monitoring of environmental indicators, especially pollution. Environmental impact assessment and licensing has been a requirement since 1994 (Ley 16,466) and is considered among the top ranked countries based on environmental performance.[3]

G. Risks and Mitigation

13. **The overall risk to achieving the PDO is assessed as Moderate.** Given the severe economic impact of the COVID-19 outbreak around the globe, the macroeconomic risk is rated as Substantial: if the projected recovery path that foresees a return to positive growth rates at end-2020 does not materialize, the country may be stretched beyond its fiscal capacity to support the businesses and households affected by the crisis. The temporary COVID-19 response measures supported through this operation would help the economy withstand the shock, while the medium-term institutional and policy reforms also contained in the policy matrix will be critical for embarking as swiftly as possible on a sustained recovery

[3] Ranked #6 according to the 2018 Environmental Performance Index. See: Wendling, Z. A., Emerson, J. W., Esty, D. C., Levy, M. A., de Sherbinin, A., et al. (2018). 2018 Environmental Performance Index. New Haven, CT: Yale Center for Environmental Law & Policy. https://epi.yale.edu/

trajectory. The risks related to Sector Strategies and Policies are rated Substantial because the timing of this operation, (prepared shortly after the new Government took up its mandate, as well as the enormous amount of personal and financial resources needed to respond to the COVID-19 crisis) may affect the ability to implement effectively the measures contained in the policy matrix and meet the result targets. These risks are however mitigated by supporting through this operation the reforms falling under the Government's priority areas, as set by the COVID-19 response package and policy package put forward in the Urgent Reform Bill. The risk categories for the Technical Design of the Program, Institutional Capacity for Implementation and Sustainability and Stakeholders are rated as Moderate. In terms of technical design and institutional capacity, Uruguay has a strong track record in terms of implementing programs, and a long trajectory of successful DPL programs with the Bank and similar programs with other IFIs. On risks related to Stakeholders, the DPL series supports further strengthening of the policies underpinning this social contract, notably those captured under Pillar 1.

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APPROVAL

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