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Possible Uruguayan Turnabout

In the past six months, Uruguay may have begun to move purposefully toward financial stability, following more than a decade of economic stagnation and severe inflation. There is a strong likelihood that the country, for the first time, complied for an entire year with virtually all of the credit ceilings and other guidelines of an IMF stand-by program. Moreover the Government has secured passage of a new law aimed at slowing down the private sector wage-price spiral and has endorsed an economic development policy oriented toward export expansion.

During the period from 1957 to 1967, the average annual price rise exceeded 40 per cent, reaching 136 per cent in 1967. In spite of the initiation of a stabilization program in October 1967, the cost of living rose 64 per cent during the first six months of 1968. Most of the fiscal and monetary goals under the program were achieved during the first half of 1968, but there was no effective control over wages in the private sector. While there was a 60 per cent increase in public sector wages in January 1968, wages in the private sector remained linked to the cost of living and rose about 70 per cent on the average during the first six months. Continuation of the inflationary situation in the light of the progress made in the fiscal and monetary areas indicated that actinn was needed to deal with the cost-price spiral, and in particular to establish some control over private sector wages.

On June 13 a limited state of siege was declared, and on June 28, under these powers, the Government of Uruguay decreed a wage-price freeze, fixing wages and prices at their June 26 level.

The effectiveness of this freeze is shown by the fact that the cost of living rose only 1.6 per cent the second half of the year with decreases actually occurring in August, September and November. Although a major wage increase for the private sector became effective December 1, 1968, the total cost of living increase for the year was 66.3 per cent, slightly less than half of the 1967 rate.

In addition to this wage-price freeze, the authorities took other basic actions to restore stability: they restricted financing of the Government budget by bank credit and placed severe controls over public expenditures, including the hiring of public personnel. In recent years, the budget deficit has been as large as 30 per cent of total expenditures. With severe restrictions on public expenditures and higher than anticipated tax collections, the cash deficit of the Government for the first 11 months of 1968 was 2.5 per cent of expenditures. This has been completely financed by the sale of Treasury notes to the commercial banks.

As a result of these measures, the Government is very likely for the first time to have ended the year in full compliance of an IMF stand-by program. The primary aims of the 1968 IMF program included an improvement in net foreign reserves and observance of a ceiling on total internal credit and of a sub-ceiling on credit to the public sector. Foreign reserves fell a little short of the second quarter target, but otherwise Uruguay has met all targets and thus has been eligible for all drawings from the Fund under the stand-by. As of November 4, the international reserves were somewhat less than provided, but credit was far below the ceiling, mainly because of the contraction of credit to the government sector; through November, net credit to the public sector declined 3.3 billion pesos. It is generally believed that the December 31 target was also met, for as of November 20, 1968, the net foreign reserve improvement was $14 million more than the fourth quarter target of $30 million, and internal credit was 2.6 billion pesos under the ceiling.

Needless to say, however, the battle is far from won. As President Pacheco emphasized in his recent State of the Nation message, the economic recovery is just beginning. While the wage-price freeze has undoubtedly been a powerful factor in the drastic reduction of the wage-price spiral, the true effect of the stabilization measures will only become apparent when economic controls are eliminated, and wages and prices are left to the determination of market forces.

The likelihood that the recovery will continue has been greatly enhanced by the December 12 passage of a Price-Wage-Productivity Bill. Continued control over private sector wages after the eventual lifting of the state of siege necessitated legislation. Consequently on July 24, 1968, the Government submitted a Price-Wage-Productivity Bill to the legislature which would set up an eight member tripartite council, the Committee of Productivity, Prices and Income (COPRIN) composed of four government representatives including the president of the council, two representatives from management and two from labor. This council will have the power to set maximum wages, to restrict the right of unions to strike, and to declare some strikes and other forms of labor disturbances illegal if COPRIN is not notified 7 days in advance. Also, no solutions to conflicts negotiated without COPRIN's knowledge will be recognized.

This bill aroused hostility among various segments of the society and was the cause of much political agitation. During the Bill's progress through the legislature, informed observers tended to be pessimistic about its chances. Many believed that the price control provisions would come through intact, but few believed that the sections on labor control would get through the legislature without major alteration. Nevertheless on December 12, Congress passed the controversial bill substantially as submitted. This represents a major milestone on the road to stability.

The task of setting up the machinery called for by the new law and enabling it to function efficiently is still to be accomplished. This must be done by March or April, for it is then that the renewed labor demands for wage increases to compensate for the cost of living increases are expected to arise.

A second problem to be faced by the authorities is the effect of wage increases. The wage-price freeze has not yet been associated with a large rise in unemployment, but it was not until December that there were any major wage increases. The first increase, effective December 1, was in the private sector and ranged from a high of 25 to a low of 6 per cent depending on whether the last raise was in January or Jnne, respectively. With this increase, an appeal was made to the employers to assume the added wage bill without raising prices, although cases of special hardships could be presented to the government for consideration. It should not be long before the true success of this approach to control of wages and prices becomes apparent.

The second increase, effective January 1, 1969, was in the public sector. It provided for a 30 per cent wage increase plus increases in child and family allowances. This will increase the public sector wage bill 50 per cent and may well bring about a large public deficit.

A final encouraging note on Uruguay is found in President Pacheco's State of the Nation Message late last year. In this speech, he emphasized his firm determination to continue to pursue the severe and painful economic program to restore financial stability. He noted that it is only when this stability has been achieved that Uruguay will be able to generate sufficient domestic savings for necessary investment and thus no longer be dependent upon foreign aid. He expressed the view that foreign aid is necessary for the present, but future dependence upon it is highly undesirable.

For a lasting solution, he reaffirmed that stabilization must be accompanied by an export expansion to which, on other occasions, he has ascribed a leading role in promoting economic growth. Recent measures directed to the promotion of both traditional and non-traditional exports reflect this line of thinking. First, wool export taxes are to be gradually eliminated over a three-year period and replaced with an Agricultural Productivity Tax which will be implemented in three stages beginning October 1, 1968. Second, the Bank of the Republic has established a program for promotion of non-traditional exports. This consists of a credit program for pre-financing exports and rebates on exports in order to provide pesos to exporters to obtain necessary materials for processing the exports. In addition, the program is designed to compensate the exporter for the difference in peso receipts if a devaluation occurs between the time the trade agreement is contracted and the receipt of payment for the exports.

Thus for the first time in many years, Uruguay appears to be moving toward economic stability. The wage increases granted toward the end of 1968 make it unlikely that the cost of living can continue the virtual stability of the last few months in the first part of 1969. But if the fiscal and monetary policies of 1968 are continued this year, the increase in the cost of living may again slow down later on. The hope is that a return to slower increases in prices will eventually reduce the intensity of the demands for wage increases and pave the way for the removal of the wage controls.