PUBLIC AS OF JANUARY 1, 2009

L. 5. 2.

RFD 592

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

July 28, 1966

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Uruguay: An Advanced Case of the English Sickness? 28 pages

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Introduction

Last July, Dr. Paul Einzig characterized the economic policy of Britain, and more specifically the exchange and payments policy of the country, as being afflicted with the "English sickness." 1/ He defined this malady as "...the attitude of trying to get as much as possible out of the community in return for contributing as little as possible towards the community."

Placing aside the question of whether or not the name Dr. Einzig has given this inclination is appropriate, there is no doubt that the attitude described has been an important element in the chronic economic troubles that have befallen some countries in the postwar period. Uruguay is perhaps one of the best examples of the malady and its consequences. Uruguay has chosen to emphasize consumption over production, and has followed a public policy reflecting this inclination. Today, it is debilitated by the struggles of special interest groups, having experienced the logical consequences of its prodigality. Those who are interested in the prognosis of the "English sickness" should examine the recent economic history of Uruguay and its fall from relative prosperity to stagnation and insolvency.

In 1950, Uruguayan prosperity rested on a solid foundation of cattle and wool production. This small nation of 2 million exported about 63,000 metric tons of beef and 96,000 metric tons of wool. Uruguay's beef exports were about the same as those of New Zealand, while its exports of wool were about one-half those of the latter country. These two products accounted for some 80 per cent of Uruguay's exports. Despite this heavy dependence on only two commodities, Uruguay had achieved a very respectable level of per capita GNP, probably the third highest in Latin America. In 1950 this compared very favorably with levels of income in many European countries and Japan. Uruguay was already a modern, highly civilized country, thoroughly European in outlook, with a long record of political and financial stability. Indeed, it was sometimes labeled "the Switzerland of Latin America," partly because it actually attracted capital from other Latin American countries seeking a safe haven from inflation and political upheaval.

1/ See: Paul Einzig, "Is Mr. Fowler Infected with English Disease?", The Commercial and Financial Chronicle, July 22, 1965, page 11.

But Uruguay chose to live beyond its means over an extended period, and increasingly relied on foreign borrowing while depleting its capital base. This occurred despite mounting warnings of economic catastrophe. Like some other Latin American nations, Uruguay was caught up in the socio-political transformation of the past few decades, characterized by increasing urbanization and emphasis upon industrialization. At least until very recently, Uruguayan agriculture experienced years of disinvestment, neglect and stagnation. The manufacturing industries fostered by protectionism and various forms of subsidy managed to achieve a modicum of success in import substitution, but they proved singularly undynamic from a managerial standpoint and unable to compete in world markets.

Advancing structural disequilibrium derived from an implicit decision to ignore the laws of absolute and comparative advantage. It was compounded by consistently unrealistic wage increases, progressive deterioration of the agricultural sector, inefficient operation of state enterprises and agencies and fiscal budget deficits traceable mainly to the cost of subsidies to elements of both the public and private sectors.

What are the facts of this long-term deterioration, and in what ways were they related to public attitudes and to conscious public policy? To answer these questions, it is necessary to explore the record of the Uruguayan economy, sector by sector.

A. The Internal Economy

1. Production

The data in Table I clearly indicate economic stagnation during the period being considered. In terms of 1955 pesos, gross national product in 1963 was only 8 per cent more than it had been eight years earlier. There were some mild fluctuations over the period, with a high point reached in 1961, but there was little if any progress. Uruguay would appear to have fallen far short of its potential for growth.

Table I

Uruguay-Gross National Product, 1955-1963 a/

	1955	1956	1957	1958	1959	1960	1961	1962	1963
GNP in billions of current pesos	4.59	5.15	6.10	6.60	8.84	13.54	17.26	18.81	22.47
GNP in billions of 1955 pesos (1955 c.o.l.=100) 1/	4.59	4.87	5.02	4.62	4.45	4.89	5.10	5.01	4.96

a/ Figures for 1953, 1954, 1964 and 1965 are not available.
Source: International Financial Statistics, January 1964 and January 1966.
1/ The author recognizes that there are pitfalls associated with statistical deflation, particularly when the realism of the cost-of-living utilized is subject to question. But, with certain reservations implied, it is felt that the deflations calculated in Table I and for subsequent data in this paper give a consistent, if rough, indication of real economic developments in Uruguay.

a. Agriculture

From 1950 to 1964, crop production in Uruguay tended slightly downward. Generally after the 1957-58 season lower harvests of wheat, the single most important crop, accounted for the decline. Taking seasonal fluctuations into consideration, production of flax, oats, barley, corn, sunflower seed and rice made little progress over the period. (See Table II).

Table II

Uruguay-Agricultural Production, 1953-1964 1/
(thousands of metric tons)

	50-51	51-52	52-53	53-54	54-55	55-56	56-57	57-58	58-59	59-60	60-61	61-62	62-63	63-64
Wheat	435	478	463	819	854	876	589	598	360	183	413	372	452	237
Flax	90	142	109	65	63	53	72	73	72	50	67	96	84	62
Oats	34	38	38	60	33	41	56	52	33	21	62	64	57	56
Barley	25	18	22	40	42	29	44	31	24	29	49	30	35	19
Birdseed	1	*	*	1	1	3	7	1	2	1	2	3	5	3

	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	Period Average
Corn	89	278	117	208	212	192	209	168	276	133	78	220	155	206	91	179.0
Sunflower seed	42	118	109	92	81	85	80	79	131	48	72	57	80	87	63	79.6
Rice	40	37	47	53	62	68	64	57	58	49	53	54	61	61	47	58.6
Peanuts	4	9	3	2	6	5	6	-	-	3	5	7	8	7	7	4.8

1/ Crops only.
* Less than 500 tons.
Source: Banco de la Republic Oriental del Uruguay, Suplemento Estadistico de la Revista Economica, Enero 1965, page 56.

As indicated by Table III, livestock sales to packers in Montevideo have been fairly stable in recent years. Although the 1950 high point of 342,000 metric tons was not equalled in any year through 1964, annual sales for the 1960-1964 period were at about the average for the full twelve years. Wool production reached a peak in 1954 which has not been matched since then. However, after declining through 1960, it recovered to within 5 per cent of the 1954 level.

Thus, it appears that overall agricultural production was near the same level in 1964 as it was in 1953. Agricultural production per capita may have declined, although it must be granted that the above data do not take qualitative changes into account.

During the early 1950's the Korean War provided a stimulus to general agricultural production in Uruguay through the means of increased world prices. At the same time, and for several years after the cease-fire in Korea, Uruguayan policy emphasized production of wheat. The diversion of resources to this crop, which could be produced in Uruguay only at high cost, was related to Peronist policy in Argentina. Uruguay was concerned about over-dependence upon Argentina as a source of wheat supply, fearing that this might be used by the Peronists to bring pressure on Uruguay. To avoid this, Uruguay determined to produce its own wheat. High price supports were set to stimulate cultivation. Wheat output more than doubled from 1951 to 1956, but production of cattle declined as land was shifted from cattle to wheat. By 1958, cattle stocks had become decimated and the country was experiencing a serious shortage of meat. In the 1960's, wheat production has fallen and cattle production has risen, but livestock sales to packers still remain below the 1950-53 average.

Uruguay's experiment with expanded wheat production was an economic dead end, because it shifted resources from an efficient type of production to one that was less efficient. A similar policy has prevailed with respect to manufacturing. Although agricultural products have been the only things that Uruguay has been able to export in quantity, indicating this to be the efficient sector of the economy, much of the profit of crop and cattle production has been siphoned off through exchange policy and uneven taxation placing a penalty on investment in cattle and agriculture. At the same time manufacturing has been given highly favored treatment.

One predictable result of the discrimination against the rural sector has been a distinct lag in the modernization of agricultural technology. Investment in machinery and utilization of fertilizers and pesticides has been inadequate compared with the advance of agricultural techniques elsewhere in the world. Uruguay has been slow to introduce better grasses into her grazing lands. For these reasons Uruguayan agriculture has declined in efficiency in comparison with more progressive countries.

Table III-a

Uruguay-Livestock Sales to Packers in Montevideo, 1953-1964 1/
(thousands of metric tons)

	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964
Cattle	342	264	286	340	192	201	249	167	109	136	232	231	264	274	259
Sheep	21	12	27	15	8	25	22	10	4	2	4	2	2	1	NA
Pigs	9	9	9	11	13	14	13	13	12	13	12	12	13	14	NA

1/ NOTE: Although these data do not encompass all Uruguayan livestock production, they account for the bulk of the livestock market; 1965 data unavailable.
Sources: Banco de la Republica Oriental del Uruguay, Suplemento Estadisto de la Revista Economica, Enero 1955, pages 26-27, Enero 1959, pages 26-27; Enero 1962, pages 26-27.

Table III-b

Uruguay-Wool Production (Greasy Wool Basis), 1951-65 1/
(millions of pounds)

1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
181	187	190	202	192	178	187	178	176	159	180	185	190	194	190

1/ Data refer to 12 month periods beginning October 1 of preceeding year.
Source: U.S. Department of Agriculture.

b. Industry

Table IV indicates the trend of Uruguayan industrial activity in those years for which a consistent index is available. It shows that industrial production in 1962 was only slightly above the level of 1955, and that the general index had been declining since 1957. Some of the sectors in which performance was particularly disappointing over the period were textiles, finished clothing, foundry products, electrical equipment and building materials. In terms of physical production, these sectors declined by 10 per cent or more. There is no evidence to suggest that there has been a marked upsurge of industrial activity in the period since 1962. In fact, the import restrictions imposed in 1965 probably contributed to a shortage of some items vital to industry. With per capita consumption probably still declining, and with exports of manufactured goods negligible, it is virtually certain that industrialization did not advance after 1962.

Table IV

Uruguay-Index of Industrial Production, 1955-1962 1/

	1955	1956	1957	1958	1959	1960	1961	1962
General Index	96.6	101.5	103.6	102.8	101.2	101.3	100.0	99.5
Food Products	114.3	115.8	104.1	105.8	93.0	101.5	100.0	101.7
Beverages	91.3	91.0	89.0	95.5	88.8	94.6	100.0	115.1
Tobacco Products	74.6	78.4	94.5	97.7	98.2	100.4	100.0	108.9
Textiles	113.2	140.4	123.1	117.7	125.3	96.7	100.0	89.1
Clothing	83.0	98.2	114.9	128.4	122.2	104.4	100.0	87.9
Forest Products	160.1	158.3	164.4	133.1	126.6	101.2	100.0	103.1
Furniture	98.5	99.0	121.8	99.1	82.8	87.1	100.0	92.5
Printing	87.2	85.4	105.7	112.5	99.5	123.6	100.0	95.2
Leather goods	120.7	119.0	104.6	119.2	111.8	94.5	100.0	109.2
Rubber products	39.9	86.4	81.5	120.7	90.6	134.2	100.0	NA
Chemicals	86.4	76.9	101.2	97.9	99.0	96.2	100.0	93.9
Foundry Products	125.9	105.0	140.8	111.9	123.1	114.2	100.0	88.8
Metallurgy	143.2	162.1	135.5	103.8	114.8	119.0	100.0	97.5
Machine Fabrication	102.6	91.6	125.3	109.6	117.6	123.0	100.0	116.9
Electrical Equip.	67.9	59.8	70.5	63.8	69.5	82.5	100.0	86.1
Plastics	47.6	64.4	55.8	70.7	81.2	88.9	100.0	101.4
Building Materials	81.7	88.3	107.1	108.9	111.1	114.2	100.0	91.3
Paper Products	59.9	49.4	117.1	107.5	112.9	131.8	100.0	103.8
Other	101.5	89.9	90.0	89.8	88.8	99.1	100.0	111.0

1/ Does not include extractive industries or construction activity.
Source: Banco de la Republica Oriental del Uruguay, Suplemento Estadistico de la Revista Economica, Enero 1965, page 85.

Despite the legal and institutional bias in favor of the urban, industrial center of Montevideo at the expense of rural Uruguay, even some of the more basic import-substitution oriented industries have made little headway. There are a number of obvious explanations for this. First, there is the smallness of the Uruguayan market. The total population of the country is only 2 million. To this has been added policies that have diminished the prosperity of a substantial segment of the market--the agricultural sector. Rather than concentrate on products that might have commanded a wider market by being saleable in foreign countries, Uruguay has encouraged production of many goods that can be sold only in Uruguay, and only there because of the high degree of protection provided. This, of course, has not provided an environment in which efficiency, productivity, and inventiveness have been encouraged.

Plastic goods provide an example of the degree of protection provided Uruguayan manufacturers. In addition to stiff duties on finished plastic goods imports, there is a surcharge of 225 per cent of the landed value of most plastic containers, plus prior import deposits of 200 per cent ad-valorem, plus a new supplementary prior deposit of as much as 100 per cent of landed value. An industry that requires this degree of protection exacts heavy tribute from the consumers and lowers the standard of living in the country below what it might be if the labor and capital were used in a more efficient field. The plastic goods production is expanding but the country is being forced to pay too high a price for it.

2. Investment and Consumption

Both in real (deflated) terms and as a percentage of gross national product, private investment rose over the period 1955-1963. Table V shows the trend for the period. This indicates a rising capital output ratio. This fits the other evidence that policies have diverted investment from the efficient to the relatively less efficient sectors of the economy. It is confirmation of the principle that the quality of investment may be more important than its quantity in determining the rate of economic growth.

Table V

Uruguay-Private Investment and Consumption, 1955-1963 a/

	1955	1956	1957	1958	1959	1960	1961	1962	1963	Period Average
Private invest. in billions of current pesos	.46	.44	1.00	.76	1.12	2.21	2.56	3.30	3.26	
Private invest. in billions of 1955 pesos (1955 c.o.l.=100)	.46	.42	.82	.53	.56	.80	.76	.88	.72	(.66)
Private invest. as a % of GNP	10.0	8.5	16.4	11.5	12.7	16.3	14.8	17.5	14.5	(13.6)
Private consump. in billions of current pesos	3.64	4.03	4.79	5.11	7.20	10.73	12.74	13.99	16.43	
Private consump. in billions of 1955 pesos (1955 c.o.l.=100)	3.64	3.81	3.94	3.58	3.63	3.87	3.76	3.73	3.63	(3.73)
Private consump. as a % of GNP	79.3	78.3	78.5	77.4	81.4	79.2	73.8	74.4	73.1	(77.3)
Private consump. per capita in 1955 pesos (thousands)	1.5	1.6	1.6	1.4	1.5	1.5	1.4	1.4	1.4	

a/ Figures for 1953, 1954, 1964 and 1965 are not available.
Source: International Financial Statistics, January 1964 and January 1966; United Nations, Monthly Bulletin of Statistics, various issues.

Life in Uruguay has become oriented toward consumption, speculation and an internecine factional struggle to secure greater portions of the national income for each special-interest group. How has the average Uruguayan consumer fared in these surroundings? Table V reveals the unfortunate truth. In deflated terms, aggregate private consumption in 1963 was no greater than it was in 1955. Consumption per capita declined, despite Uruguay's slow rate of population growth over the same period. Because of continual inflation, one would suspect that a certain redistribution of income has occurred. But whatever other economic indicators may show, it is clear that the average consumer has not improved his lot. In fact, since the cost-of-living index employed in computing the deflated figures used in this paper probably understates price inflation, the standard of living has likely fallen substantially.

3. Prices and Credit

The cost of living in Uruguay has tended upward since 1950, as is indicated in Table VI. The 1950-1951 price increase may be partially attributed to the surge in income that came with the Korean War boom. However, inflation was especially rapid from 1958 to 1960, and it again became severe in 1962. Recently, however, a new record was set for price increases; inflation in Uruguay is estimated at a minimum of 85 per cent for the year 1965, depending upon the index employed.

The causes of inflation in Uruguay have been multiple. Central Government budget deficits, due principally to subsidization of public enterprises, and excessive public personnel have been an important expansionary factor at times, especially since 1961. At times, also, the Bank of the Republic has suffered losses on its operations in the complex exchange system. But the major factor has been the undue expansion of credit to the private sector, both by the commercial banks and by the Bank of the Republic, which carries out both commercial and central banking operations. As is well known, once an inflationary spiral gets underway, individual banks struggle to keep ahead of their competition by meeting customers' demands for an ever-larger volume of credit to cover increased payrolls and other factor costs. Unless bank credit is restrained through restrictive monetary policy, there is little obstruction to growth in the money supply. Apparently, restraint has been missing in Uruguay in this period.

Table VI

Uruguay-Consumer Price Index, 1947-1965 1/
(1953=100)

	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959
Cost of living	65	66	68	66	82	91	100	108	128	136	161	193	286
% change over preceeding year	--	+ 1	+ 3	- 3	+24	+11	+ 10	+ 8	+ 19	+ 6	+ 18	+ 20	+ 48

	1960	1961	1962	1963	1964	1965
Cost of living	390	430	527	758	1274	2395
% change over preceeding year	+ 36	+ 10	+ 23	+ 44	+ 68	+ 88

1/ December figures.
Source: United Nations, Monthly Bulletin of Statistics, various issues.

As shown in Table VII, the money supply followed a distinct upward trend from 1953 through 1964, as would be expected in view of the price performance over the period. Especially large expansions in means of payment took place from December 1957 to December 1958, from 1958 to 1959, and from 1962 to 1963. But these increases in money supply were overshadowed by the change from 1963 to 1964. Further, although complete data are not yet available, it is apparent that the 1965 growth in money supply was greater still. Rapid price inflation, galloping increases in money supply and stationary gross national product indicate that much Uruguayan investment in the last 15 years must have been of a non-productive type.

Table VII

Uruguay-Money Supply, 1953-1964

	1953	1954	1955	1956	1957	1958	1959	1960
Money supply (millions of pesos) 1/	698	751	789	890	944	1,235	1,767	2,232
Per cent change over previous year	--	+ 7.6	+ 5.1	+ 12.8	+ 6.1	+ 30.8	+ 43.1	+ 26.3

	1961	1962	1963	1964	1965 2/
Money supply (millions of pesos) 1/	2,828	2,854	3,527	5,352	9,501
Per cent change over previous year	+ 26.7	+ 0.9	+ 23.6	+ 51.7	+103.3 3/

1/ Figures as of end of period and seasonally adjusted after 1959.
2/ September.
3/ Annual rate.
Source: International Financial Statistics, January 1964 and March 1966.

In money terms, there was a more than fifteen fold increase in total bank credit to the private sector from 1953 to 1965. In deflated terms, the increase was about 20 per cent from 1953 to 1964 (See Table VIII.) Since real GNP scarcely rose at all in this period, even this small increase in bank credit in real terms tended to exert a strong inflationary leverage. Although it reached a peak in 1958, and declined thereafter, this inflationary leverage was significant and sustained over the period.

Table VIII

Banking System Claims on Private Sector, 1953-1965
(millions of pesos)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965 1/
Deposit Money Banks' claims on priv't sector, in current pesos (average of last month of period)	772	958	1,058	1,270	1,468	1,913	2,449	2,949	3,578	4,104	4,725	7,376	12,625
Deposit Money Banks' claims on priv't sector, in 1955 pesos (1955 c.o.l.=100)	948	1,047	1,058	1,201	1,209	1,339	1,233	1,064	1,057	1,057	1,043	1,137	
Bank of the Republic claims on priv't sector in current pesos (end of period)	373	407	490	568	688	781	950	1,392	1,483	1,717	2,140	3,206	4,751 2/
Bank of the Republic claims on priv't sector, in 1955 pesos (1955 c.o.l.=100)	458	445	490	537	567	547	478	502	438	457	473	494	

1/ Data on a revised basis, not fully comparable with earlier years.
2/ September.
Source: International Financial Statistics, Supplement to 1965-66 issues and June 1966.

It seems that in Uruguay inflation and distortions associated with it have been largely caused by the lack of monetary restraint or effective control of the banking system. While credit extended to the private sector has probably been the primary inflationary force, budget deficits financed by the Bank of the Republic contributed heavily in the period 1961-1965.

4. Public Sector Operations

The course of general government expenditure for the years 1955 through 1963 is shown in Table IX. The rise in expenditure was relatively moderate until 1960 when spending rose abruptly. As the gross national product stagnated, public sector spending as a percentage of G.N.P. rose after 1960.

Table IX

Uruguay-General Government Revenues and Expenditures, 1955-1963 a/

	1955	1956	1957	1958	1959	1960	1961	1962	1963
Data in billions of current pesos									
Revenues	1.20	1.39	1.48	1.60	2.08	3.29	4.50	5.21	6.35
Expenditures	1.04	1.16	1.43	1.63	2.03	3.11	4.16	5.64	6.57
Surplus (Deficit)	.16	.23	.05	(.03)	.05	.18	.34	(.43)	(.22)
Data in billions of 1955 pesos (1955 c.o.l.=100)									
Revenues	1.20	1.31	1.22	1.12	1.05	1.19	1.33	1.39	1.40
Expenditures	1.04	1.09	1.18	1.14	1.02	1.12	1.23	1.50	1.46
Surplus (Deficit)	.16	.22	.04	(.02)	.03	.07	.10	(.11)	(.06)
Gov't. expenditures as % of GNP	22.6	22.5	23.4	24.7	23.0	23.0	24.1	30.0	29.2

a/ Data from national accounts statistics. Figures for 1953, 1954, 1964, and 1965 are not available.

Source: Statistical Bulletin for Latin America, Volume III, No. 1, page 240.

The increased government spending of recent years is attributable to the burden of social welfare costs, the maintenance of excessive numbers of public sector employees, and the subsidization of various enterprises. The transportation industry in particular, is notorious for its inefficiency and perennial operating deficits; the Government of Uruguay makes up the difference.

Unfortunately, the tax revenues needed to meet such costs were often not forthcoming. While the public sector had small surpluses in the 1950's (except in 1958), the upsurge in spending resulted in substantial deficits in 1962 and 1963. Beginning in 1962, the Government relied heavily on credit from the Bank of the Republic to finance its deficit. (See Table X.) It was this, superimposed on unrestrained expansion of private credit, that has accelerated the rise in prices in recent years. Tax evasion on a wide scale contributed to fiscal difficulties. Prolonged deterioration of the peso and a highly developed propensity to consume added to the difficulties of locating non-inflationary means of placing Government debt obligations.

Social welfare and subsidization programs are always difficult to cut back once they are firmly established. The various groups which benefit from them resist any cut-back and may even fight to expand them further. Uruguay has been caught in a bind caused by expenditure levels that are politically irreducible and revenue levels which are difficult to expand partly for political reasons and partly because of the stagnation of the economy. The resulting deficits have produced inflation, not economic stimulation. This in turn has tended to deepen the dilemma, by increasing the demands on the Treasury and producing further distortions to impair economic efficiency.

5. The Social Security System

Social welfare in Uruguay is characterized by many laws and regulations and by several administrative institutions with overlapping activities. Eligibility for pensions or other benefits is ascertained under two systems, according to categories of workers and according to types of coverage. Most, if not all, workers are covered by some social security plan administered by one of the funds (cajas). The types of coverage are, for example, pensions or retirement pay, health benefits, survivorships and others.

Table X

Uruguay-Bank of the Republic Claims on Government and Official Entities
1953-1965
(End of Period)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965 1/
Data in millions of current pesos													
Gross claims	170	225	288	368	394	406	398	446	452	820	1,215	2,092	5,543
Gov't deposits	88	91	102	107	112	123	243	516	585	306	265	524	2,267
Net claims	82	134	186	261	282	283	155	- 70	-133	514	950	1,568	3,276
Data in millions of 1955 pesos (1955 c.o.l.=100)													
Gross claims	218	266	288	346	313	269	173	146	135	199	205	210	296
Gov't deposits	113	108	102	101	89	82	108	169	174	74	45	53	121
Net claims	105	158	186	245	224	187	65	- 23	- 39	125	160	157	175

1/ Data on a revised basis, not fully comparable with earlier years.
Source: International Financial Statistics, January 1964 and January 1966.

Over a long period, there has been a proliferation of laws on the basis of technical adjustments without adequate previous investigation of potential long-run economic and social repercussions. In 1964, the International Labor Office made a study of the Uruguayan social security system which revealed many grave defects. [1/] The ILO found considerable avoidance of contributions, favoritism, depletion of social security funds by the central government and general mismanagement. It reported that the complicated nature of the overall social security system results in frequent duplication of payments.

Although every salaried and independent worker is theoretically affiliated with one of the social security system institutions, evasion of worker contributions is widespread. Those shrinking their lawful contributions often receive pension payments, thereby adding to the system's burden. Age requirements for eligibility are sometimes quite low, so that many persons spend much of their lives on at least a partial dole. Because of loose administration, many are able to receive unemployment compensation while busy at new jobs. Some manage to get more than one pension. Destruction of the social function of pensions is completed by massive exceptions to eligibility rules. Retirement pensions are often too high relative to recipient family financial responsibilities, in the case of older couples with one child at home. On the other hand, protection for persons disabled early in life is quite insufficient; the same is often true for survivors of deceased wage-earners, except that when a child or wife becomes an established beneficiary his pension is likely to be astoundingly generous.

The munificence of pension systems in general is partly offset, however, by the time required for processing of applications. This frequently takes years. Abuses through preferential treatment are common. Many deserving but powerless persons are bypassed. It is clear that the authorities of the various social security institutions neither award nor pay just pension claims reasonably promptly.

A basic cause of the situation is found in the political nature of the superior bodies of the cajas, whose officers are appointed on a patronage basis. Interference in the normal processing of applications, such as giving certain cases special priority, hinders the progress of normal work and destroys caja employee discipline and morale. Promotions within the cajas are based upon political considerations, rather than upon the merit and capacity of the employee. Most officials simply go along with the system.

1/ International Labor Office, Report to the Government of the Oriental Republic of Uruguay on Social Security (in Spanish). The discussion is based on the ILO report.

The cost of operating the social security systems appears in the steadily ascending legal rates of contribution for employees and employers. These now are in the vicinity of one-third of basic pay. Despite the level of these social security tax deductions, the two largest cajas are on the brink of bankruptcy. The precarious financial situation can be traced to the number of persons declared eligible for pensions, duplication of payments, the system of automatic adjustments according to a "flexible scale," evasion of lawful contributions by individuals and the Government's borrowings from the funds of the cajas.

The heavy cost of social welfare tends to depress production and the economy in general. Not only are direct contribution costs high for entrepreneurs, but there is also an oversize body of public sector employees, whose social security is financially borne by the private sector. As might be expected, some businesses manage to evade their required contributions, and this results in additional distortions in competitiveness and use of resources. Many employers lose valuable workers at the height of their productive efficiency. The population is increasingly oriented to living on the efforts of others, and the social benefit of pensions has been supplanted by elements of speculation and power politics.

In order to remedy this problem, the social security system would require a complete overhaul. According to the ILO report, concurrent elements of the needed renovation would be (1) reform of the legal underpinnings which serve as rules for granting of pensions; (2) reform of the administration and means of financing the system; (3) incorporation of a means of establishing desirable social and economic results to be achieved through an intelligent social security system and establishment of a permanent means of evaluating each proposed change in the system. The overall reform should reduce pensions to a level conforming to the realistic financial capacity of Uruguay. It is believed that only through these changes will the accumulated distortions and abuses of the past two decades be rectified, with a consequent dissolution of the system's present unsavory effect upon the socio-economic structure.

Table XI

Uruguay-Trade Data, 1953-1964

	1948-1949	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
Value of Trade (in millions of U. S. dollars)														
Exports (f.o.b.)	184.6	269.5	248.9	183.1	210.7	128.1	138.6	97.8	129.4	174.7	153.4	165.2	178.9	191.2
Imports (c.i.f.)	190.1	193.1	274.5	228.5	212.6	254.7	151.3	159.7	244.4	207.9	229.9	176.9	197.9	150.7
Trade Balance	5.5	76.4	-25.6	-45.4	- 1.9	-126.6	-12.7	-61.9	-115.0	-33.2	-76.5	-11.7	-19.0	40.5
Trade Indices (1958=100)														
Volume of Exports	100	144	129	100	129	77	100	78	88	122	101	108	99	114
Export Prices	128	140	146	129	117	128	100	95	118	111	116	124	138	115

Source: International Financial Statistics, January 1964 and January 1966.

B. The External Economy

1. Trade, Payments and Reserves

As shown in Table XI, on the preceding page, Uruguay experienced a surplus on commodity trade in only two years during the period 1953-1965. Sustained efforts to 'save' foreign exchange by manipulation of the exchange system and encouragement of import substitution industries, held imports down after 1954 and their annual average over the last 11 years barely exceeded the 1948-1949 level. But exports fared even worse, averaging 13.5 per cent below the 1948-1949 level in the same period.

The sharp decline in Uruguay's export earnings after the end of the Korean boom was more the result of a drop in export volume than prices, although the price decline was a sharp one. At their low, in 1959, Uruguayan export prices were 32 per cent below the 1953 level, but export volume was down 46 per cent. Both prices and volume rose after 1959. In 1964, prices were nearly back to the 1953 level, but volume was still 31 per cent below 1953.

What this suggests is that Uruguay has failed to realize her full export potential for the past decade and a half. As Table XII shows, New Zealand and Australia have been able to expand the volume of their wool exports to fully offset any decline in price from the abnormal 1953 level. (Actually New Zealand obtained higher prices for wool in 1964 than in 1953.) Even Argentina, which

Table XII

Volume and Value of Exports of Uruguay and Competing Countries in 1964
1953=100

	Wool		Meat		Hides		Linseed Oil		Overall	
	Volume	Value	Volume	Value	Volume	Value	Volume	Value	Volume	Value
Uruguay	43	41	168	168	90	70	79	28	69	67
New Zealand	141	157	150 1/	237	n.a.	147	n.a.	n.a.	147	164
Argentina	71	69	202	212	114	55	172	155	156	125
Australia	128	103	160 1/	205	n.a.	100	33 1/	n.a.	166	153
South Africa	108	93	504 1/	n.a.	n.a.	88	50 2/	n.a.	204	176

1/ 1963.
2/ 1962.
Sources: International Financial Statistics, Supplement to 1965-66 issues, FAO Yearbook of Agricultural Statistics, U. N. Yearbook on the Composition of Trade.

has not been an outstanding performer in the export field, had greater success in sustaining the volume of wool exports than did Uruguay between 1953 and 1964. 1/ Argentina also did much better than Uruguay in expanding meat exports, and she increased the volume of exports of hides and linseed oil, while Uruguay experienced sharp declines in the volume of sales of these commodities.

It was not that Uruguay discovered that she could do better by specializing in the production of other commodities as export prices fell. Wool, meat, hides and linseed oil accounted for about 90 per cent of Uruguay's exports in 1964, as they had in 1953. There was no impressive development of new exports. Uruguay simply turned inward and ceased to be a vigorous competitor in the fields in which her comparative advantage evidently lay. Her competitors naturally benefited from this withdrawal. Uruguay could obviously not produce everything her 2 million people required, but with declining export earnings, it became progressively more difficult to pay for the imported goods that were demanded. In 1965, Uruguay's imports were a mere $151 million, less than half the peak level of 1951 and 25 per cent below the level of 1948.

Uruguay's obvious failure to exploit more fully her comparative advantage in agriculture has been the major factor underlying the country's general economic stagnation.

The overall balance of payments of Uruguay for the years 1953-1965 shows that the country suffered an adverse balance on the goods and services account which was accompanied about equally by capital inflows and by a deterioration of the net position of the monetary authorities (aside from errors and omissions). (See Table XIII.) Available data indicate that the private sector was primarily responsible for the growth in external debt. Although no adequate breakdown of aggregate investment for the entire 1953-65 period is available, it may be surmised from the observed trends in the economy that the funds borrowed from abroad were not channelled into investments which increased the efficiency of Uruguayan production. Heavy foreign liabilities were incurred without a corresponding growth in the ability of the country to service the external debt.

1/ Both Argentina and Uruguay experienced sharp declines in the volume of wool exports in 1964. In 1963, Argentina's wool exports by volume were 98 per cent of 1953, while Uruguay's were only 60 per cent of the 1953 level.

Table XIII

Uruguay-Balance of Payments, 1953-1964 1/
(U.S. $ million)

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1953-65 total
Goods & Services	71	-33	-51	- 6	-123	-10	-50	-75	-23	-72	- 5	- 8	59	-326
Transfers	- 2	- 2	- 2	- 2	- 1	- 2	3	1	5	4	4	4	4	14
Capital:	15	3	-12	6	27	10	15	33	30	39	1	-15	52	197
Private	NA	NA	NA	10	31	14	4	19	37	40	- 6	14	52	187
Central Gov't	NA	NA	NA	- 4	- 4	- 4	11	14	- 7	- 1	7	- 1	*	10
Deposit Money Banks:	NA	NA	NA	NA	NA	NA	-12	2	13	11	7	38	1	
Assets	NA	NA	NA	NA	NA	NA	-13	12	2	3	4	1	7	
Liabilities	NA	NA	NA	NA	NA	NA	1	-10	12	8	4	36	- 6	
Monetary Authority	-82	37	88	-20	50	14	31	28	-25	64	- 3	21	-33	170
Errors & Omissions	- 2	- 5	-23	22	47	-13	12	12	1	-47	- 5	-39	-83	123

1/ Minus sign indicates debit; figures rounded to nearest $1 million.
Source: 1953-1958, International Finaicial Statistics, Supplement to 1964/1965 issues; 1959-1964, International Financial Statistics, Supplement to 1965/1966 issues; 1965, International Financial Statistics, June 1966.

* Less than .5

Although a result rather than a causative or explanatory factor, the deterioration of Uruguay's external reserve position demonstrates one of the consequences of devotion to policy not based upon economic realities. Continued Uruguayan efforts to promote rapid industrialization and overly-generous social welfare produced a severe external crisis. The countries with whom Uruguay had financial and trading relations extensively underwrote the country's level of consumption by granting large credits. Had there not been this external assistance, Uruguayan authorities would have had to face the unfortunate consequences of their policies some years ago. As Table XIII shows, there was ample warning of an eventual financial crisis. Uruguay's official net external position worsened rather steadily from 1953 to 1965. When the liabilities of the commercial banks are included, the picture is much worse.

Uruguay's decline in reserves and lack of success in expanding exports is due in large measure to the complicated and discriminatory exchange systems utilized during most of the postwar period. The Uruguayan government leaned upon the exchange system for revenue to support public enterprises and welfare programs. Funds for such subsidies were derived from retention of a portion of the proceeds of agricultural exports. By making agricultural production less attractive, the exchange system also indirectly encouraged a diversion of resources into industrial activity. The system was both complicated and discriminatory because of the use of a whole spectrum of rates, partly through the process of "mixing" basic rates, and partly by setting fixed surrender values for proceeds of given exports. Although this sort of operation is not unique to Uruguay, it had an extensive development in that country. The exchange regulations were at times so involved that the managing authorities may well have lost effective control. At least, it seems reasonably certain that they could not have fully analysed in advance all of the effects upon the economy of some of the changes in exchange regulations that were implemented.

From time to time, adjustments in the relationships between the peso and foreign currencies were made. (See Table XIV.) These roughly kept pace with the internal decline in purchasing power of the peso. But no thoroughgoing and lasting reform of the system was carried out, apparently because of the authorities' attachment to the concept of a managed restrictive system. In October, 1965, a devaluation of the peso was accompanied by steps toward stabilization and by a move, ostensibly, to a unified rate. However, evidence indicates that several rates in fact developed. In May, a unified exchange rate was again decreed, as part of a program to intensify the stabilization effort. It is too early to tell whether the era of exchange system manipulations as a tool of general economic policy has ended.

Table XIV

Uruguay-Exchange Rates, 1953-1965 1/

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
Official Import Rate a/	1.96	1.96	2.17	2.10	2.10	2.10	2.10	11.03	10.98	10.98	16.40	18.70	65.00 b/
Free Rate	3.04	3.18	3.67	3.80	4.66	10.20	11.18	11.03	10.98	10.98	17.35	24.50	

1/ End of period; pesos/$U.S.
a/ Before 1959, Principal import rate or average of principal import rates.
b/ Rates ostensibly unified.
Source: International Financial Statistics, various issues.

Today, Uruguay is burdened with foreign exchange obligations which run into the hundreds of millions of dollars. During 1966 alone, Uruguayan foreign debt payments falling due are estimated to be some two-thirds of total anticipated external earnings for the period. 1/ As the prospect for a significant increase in exports is poor, Uruguay will be forced to seek substantial refinancing or to default on some of its obligations. Even with severe restrictions, it would be impossible to cut imports down to only one-third of the probable level of export earnings.

Uruguay's distress was accompanied by the insolvency of several private commercial banks in mid-1965, including the Banco Transatlantico, Uruguay's second largest commercial bank. The Banco Transatlantico had grown rapidly by means of aggressive business methods; its demise resulted from over-extention of dollar credits to Uruguayans and from wide-spread corruption. By mid-1965, it was unable to repay its obligations to U.S. banks. Even the central bank, the Bank of the Republic, found itself in a similar embarrassment, and the president and directors were replaced with government appointed "interventors." The entire Uruguayan banking system had incurred a crushing burden of external obligations. In May 1965, foreign liabilities of the banks exceeded foreign assets by some 1,500 million pesos (about $60 million at the 24 pesos/$ official rate of exchange then prevailing). This contrasted with net foreign liabilities of $8 million in December 1959.

Over much of the dozen or so years that Uruguay ran a trade deficit, a substantial portion of the balance was financed through a loss of reserves. The net external position of the Bank of the Republic became negative in the early months of 1965, as emphasis swung more to maintaining consumption via increased foreign credit. This took the form of suppliers' credits; of loans to the Bank of the Republic Banking Department by foreign commercial banks; and credit lines of foreign banks and "financial" credits of somewhat speculative nature to Uruguayan commercial banks. Table XV shows that, with the exception of 1963, Uruguayan commercial banks became generally more extended after 1959 than was true in earlier years. These figures harmonize with information that it was dollar, rather than peso, commitments that the Banco Transatlantico and the other insolvent banks were unable to meet in mid-1965.

1/ See: Ashby, David F. V., "Uruguay's Troubled Year." The Banker, January 1966, page 37.

Table XV

Uruguay-External Assets and Liabilities of the Bank of the Republic and Deposit Money Banks.
1953-1965

	1953	1954	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
Bank of the Republic ($million; end of period)													
Assets	368	333	235	218	197	195	192	187	212	211	197	190	198 a/
Liabilities	63	65	54	16	50	60	85	111	94	159	137	175	214 a/
Net position	303	268	181	202	147	135	107	76	118	52	60	15	
Deposit Money Banks (millions of current pesos; average of last month of period)													
Foreign assets	180	167	181	211	238	752	956	783	800	936	1,377	1,658	3,175 b/
Foreign liabilities	203	216	195	264	386	872	1,045	1,139	1,219	1,480	1,367	2,244	5,490 b/
Net position	- 23	- 49	- 14	- 53	-148	-120	- 89	-356	-419	-544	10	-586	-2,315
Net position as a % of foreign assets	- 12.7	-29.3	- 7.7	-75.1	-62.2	-16.0	- 9.3	- 45.5	- 52.4	- 58.1	--	- 35.3	- 72.9

a/ As of September.
b/ As of August.
Source: International Financial Statistics, January 1964 and January 1966.

III. Conclusion

Despite the scarcity of detailed information, and allowing for the inaccurate character of the data deflation performed, the pattern of Uruguay's economic decline since 1953 is still discernible. Dirigisme as practiced by the Uruguayan authorities has failed to achieve economic progress for the country. The rural sector has been depressed and industrial production has not made significant gains. The standard of living has declined somewhat, while the welfare system has lost its social function and become subject to political pilferage. The accumulated economic problem has been accompanied by a relatively excessive level of consumption financed with foreign borrowing. Although inappropriate economic policy has been the immediate cause of the economic deterioration, the problems of the country has been compounded by a political system in which responsibility is fragmented and decision-making is hampered.

The financial crisis of 1965 and the deterioration of the net reserve position made clear that the country must soon set things in order. But it is probable that only the prospect of diminishing real wages and reduced social welfare benefits brought the Uruguayan public to an awareness that some changes must be made. In any event, the ruling Blanco party took advantage of this partial change in public sentiment and adopted certain measures of economic reform over a period of weeks up to mid-October.

These included an effective devaluation and a simplification of the exchange system, ostensibly to a single free-rate mechanism responsive to real supply and demand. Alleviation of import restrictions was promised as well. The Government also expressed an intention to restrain wage increases and to restrict the growth of credit, especially to the agriculture sector. The rural areas were expected to benefit from increased peso returns deriving from a higher level of exported food and raw materials. The Government sought to restrain price increases, although it was able to do so with only minimal success. The most graphic step taken was a prohibition of the sale of beef and mutton on certain days of the week.

In the spring of 1966, additional steps were taken toward financial stabilization, including additional liberalization of imports and a new attempt at unifying the exchange rate and letting it fluctuate freely. It is too early to tell how long lasting and how successful these measures will be.

However, even if the recent attempts to change course are successful, Uruguay will still have to pay a heavy price for past errors. The maladjustment of investment, production and consumption which has occurred over a decade and a half will not be rectified in a matter of months and the rectification will be painful. The indeterminate but assuredly burdensome external debt will continue to be a problem long after the problem of short-term illiquidity has been overcome. How burdensome it is will depend on Uruguay's ability to give a dramatic boost to her lagging exports.

Uruguay's plight is an excellent illustration of the truth of the thesis that countries attempting to industrialize need to pay more attention to the productivity of capital and less to the supply. Uruguay has enjoyed a rate of saving that is at least respectable, and domestic savings have been liberally augmented by borrowing from abroad. Trouble came because the capital was not wisely employed, which points up the validity of Simon Kuznets' suggestion that it would be more meaningful if economists talked about "productivity raising outlays" than about capital formation. 1/

It is one thing to embark upon a stabilization program, but it is another to appreciate that one of the underlying justifications for stabilization is that it helps raise the efficiency of the economy. If the Uruguayans were to become convinced that the salvation of their living standard depended on a sweeping elimination of the existing barriers to efficient use of all the factors of production, they would probably be quite willing to make the individual sacrifices that stabilization will inevitable entail. If the general public cannot be convinced that a more competitive economic system, harder work and a changed pattern of investment are necessary to preserve the good life, stabilization prospects will be dim and Uruguay will continue to face an uncertain economic future.

1/ (Capital Formation and Economic Growth, A Conference of the Universities - National Bureau Committee for Economic Research. A Report of the National Bureau of Economic Research, New York, page 22.)