

# BTI 2008 | Uruguay Country Report

<b>Status Index</b>	1-10	<b>8.90</b>	# 9 of 125	
Democracy	1-10	9.90	# 1 of 125	➔
Market Economy	1-10	7.89	# 17 of 125	➔
<b>Management Index</b>	1-10	<b>6.97</b>	# 8 of 125	

scale: 1 (lowest) to 10 (highest)    score    rank    trend

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## Key Indicators

Population	mn.	3.5	HDI	0.85	GDP p.c.	\$	8,863
Pop. growth <sup>1</sup>	% p.a.	0.7	HDI rank of 177	43	Gini Index		44.9
Life expectancy	years	76	UN Education Index	0.95	Poverty <sup>3</sup>	%	5.7
Urban population	%	92.0	Gender equality <sup>2</sup>	0.51	Aid per capita	\$	4.2

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## 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 it has built, from the 1930s on, one of the first modern (almost European) bureaucratic welfare states with a high level of distribution, based on its opulent revenues from agricultural exports. The decline of the export economy in the late 1960s and early 1970s destabilized the Uruguayan model, which led to military rule in 1973 that lasted until 1985. Its demise in the early 1980s resulted in a negotiated transition to democracy. Since then, Uruguay has once again enjoyed consolidated democracy under the rule of law, with a strong civil society, a high level of participation and no substantial defects. It has no stateness problems, it has stable institutions, and all political actors show strong commitment to democratic principles. The electoral reforms of 1996 have improved legitimacy and institutional stability considerably by reducing fragmentation and strengthening the government's mandate to lead. And while past administrations postponed confronting the historical and moral dimensions of crimes committed under the military regime, the Batlle (2000 – 2005) and Vázquez (2005 –) administrations have since addressed this legacy.

During the period under review, the state of democracy in Uruguay has not changed significantly. Political and social integration have even improved slightly with the party realignment that took place in the October 2004 elections, giving the broad center-left opposition coalition around the Frente Amplio (EP-FA-NM) a clear mandate to govern for the first time and an unprecedented majority in parliament. The government of President Tabaré Vázquez, which took over in early 2005, has, to a great extent, lived up to high expectations and contained the usual phenomenon of disillusionment to certain sectors and dimensions. However, due to the country's good economic performance during this period, the Vázquez government has not yet been put to the

test. Uruguay's economic transformation has been more protracted. Its principal problems consisted in the need to: modernize and diversify a traditional, dependent and crisis-ridden agricultural export economy; to deregulate the strong public sector and contain heavy state interference; and to reform the comprehensive but no longer affordable nor effective welfare state. In addition, the relatively new, but growing phenomena of poverty and exclusion, caused by recession and excessive neoliberal experimentation since the military regime, demanded increasing efforts. Despite many obstacles, 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 (at least in good times). But progress remains limited due to international constellations and markets, as well as the performance of its larger neighbors Brazil and Argentina. To date, it has not found a sustainable new basis.

Since the late 1990s, Uruguay has suffered the repercussions of the region's financial and debt crises, which inappropriate domestic reactions and sometimes inadequate crisis management exacerbated. In 2002, Uruguay was thrown into its deepest recession of the 20th century, from which it did not begin to recover until 2003. During the first two years of the Vázquez presidency, Uruguay's recovery from this crisis has been much more visible than in the last years of his predecessor. Unemployment has gone down, farming, tourism and finance are doing comparatively well, foreign investment has gone up (though not enough), even in the new service industries, despite continued difficulties in overcoming restrictive conditions, such as the state-heavy traditions of public ownership and labor regulations, and the high Mercosur tariffs.

The quality of political management and governance in Uruguay has not changed significantly during the last two years, save a number of minor but noteworthy improvements. The end of the legislative gridlock has made policies slightly easier to implement and coordinate, although the heterogeneity of the broad Frente coalition still necessitates time-consuming negotiations within the governing majority. Major problems remain, and many reforms have moved significantly slower than expected. This applies to the wars on poverty, unemployment and corruption, to the reform of the oversized welfare state, as well as to the fight for a balanced budget, more tax equity, health care and educational reforms, infrastructural innovation and the promotion of competitive manufacturing and service industries (requiring capital), administrative efficiency, decentralization and more extended participation. Here again much will depend on the ability of the government and the political elite to compromise and mediate, balance market incentives and social responsibility and modernize the country with common sense and sufficient institutional imagination.

Keystones in this transformation will be the negotiations on public/private partnerships and joint ventures in infrastructural and other formerly state-heavy domains, the attraction of foreign capital, further steps in tax and state reforms and in overhauling the welfare mechanisms and the development of adequate tertiary education and

research institutions. Uruguay's potential positioning within (and the respective organizational reforms of) the Mercosur and the country's economic and trade relationship with the United States will also influence this process. Greater economic as well as political damage could also result from the yet unresolved and uncontained conflict with Argentina over the construction of the paper mill(s) on the Rio Uruguay, if the two countries do not come to a settlement soon.

## History and Characteristics of Transformation

Since the Batllista reforms between 1900 and 1930, which were inspired by the various presidencies of José Batlle y Ordóñez of the Colorado Party, Uruguay has been a stable democracy throughout most of the twentieth century. It was characterized by an active and strong civil society (mostly immigrants of European descent) as well as by affluence and significant distributive policies that turned the small, homogeneous and highly urbanized country into one of the first modern welfare states and a unique developmental model of its own. A boom in agricultural exports, mostly cattle, that lasted without interruption until the mid-1950s provided the basis for Uruguay's prosperity. Triggering industrialization and modernization, this boom also promoted social integration, but left the country highly dependent on 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 of the Blancos (Partido Nacional) and the Colorados with their various factions, lists and "sublemas." It combined a high degree of mobilized, participatory factionalism with mechanisms of integration and reform, which served decision-making and institution-building needs until the late 1960s. The democratic consensus was strong, social homogeneity high, and the state (and the city of Montevideo) fulfilled major functions as the provider of collective goods and services. Significant national, ethnic, religious or social cleavages were nonexistent, with the exception of the classic rift between capital and labor.

After the decline of export prices for cattle in the 1950s, the potential for distributive policies shrank and the Uruguayan model fell into crisis. An increasingly unimaginative and unreconstructed political class could not respond to the new political challenges, promote economic diversification or counter social deprivation. Instead, the established politicians, under the pressure of protests by the organized left and the insurgent urban guerrilla movement of the "Tupamaros", gradually handed power over to the military and some technocrats associated with them between 1967 and 1973. Uruguay's bureaucratic-authoritarian military regime lasted from 1973 to 1985. It was both qualitatively and quantitatively more repressive and did more damage to Uruguayan

society, human capital and elites than did the military regimes in Argentina or Chile. Moreover, it did not solve any of the problems it had addressed for its justification and ended in failure and decline. A period of transition followed (1985 – 1989), beginning in 1984 with negotiations between military “softliners” and the moderates of the opposition and leading to a gradual transfer of power back to civilian politicians. Initially, the military tried to exclude some of its most fervent opponents in the moderate leftist Broad Front (Frente Amplio) and the Blancos around Wilson Ferreira Aldunate, but they soon lost control, and the dynamics of the democratic process took over. Since the early 1990s, democracy in Uruguay can be considered as consolidated. Restoration characterized the first period of re-democratization: not only was the constitution of 1967 restored, but also the personnel, as well as the complicated electoral and party system, with all its limitations to clear mandates and legitimacy (it was not reformed until 1996). The necessary reforms of state structure, public administration, the welfare state and the heavy public sector of the economy got off the ground only slowly and were postponed.

Institutional democratization was achieved via broad consensus and cooperation, because neither President Julio María Sanguinetti (1985 – 1989) of the Colorado Party, whose faction had not collaborated with the military like much of the rest of the party, could command a majority in parliament, nor could his successors. Most of the military retained their military posts. The crucial problem of the military’s impunity for human rights’ violations during the dictatorship, was, after three years of intense conflict, technically solved to the satisfaction of the military. The decision was also politically unequivocal; a statute of limitations was written into law and approved by a clear majority in a referendum in 1989. The confrontation of the historical and moral problems involved was postponed. 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, in 1995, returned Sanguinetti (1995 – 2000) to power. The third installed Jorge Batlle (2000 – 2005), another traditional Colorado politician, though from a different faction, and this time with broader legitimacy thanks to the reformed electoral system. It was not until March 2005 that the first non-traditional (though experienced) candidate could assume the presidency: Tabaré Vázquez of the Frente Amplio, who was Batlle’s strongest contender in 1999 and won the elections of October 2004 in the first round with an unprecedented majority.

If the two last years of the Batlle administration – despite his earlier achievements – were lost years for Uruguayan politics, characterized by inertia, parliamentary gridlock, isolation and a lack of imagination, the first two years of the Vázquez presidency, with its majority in parliament, have brought new dynamism and resolution to the process, even if the government struggles at times to strike a balance between the liberal initiatives of its economic policy elites and the traditional (though moderate) interventionist demands of its more leftist clientele. In early 2007, Uruguay is doing

better politically and economically than two years before, despite the persistent constraints of its structures and traditions, and the fact that some projects have not yielded the desired results (e.g., the paper mills on the Uruguay river, or the closer economic alliance with the United States).

While the transition to democracy in Uruguay was completed in less than a decade, the transformation of the economy, which had already begun under military rule, was more protracted. Here, the problems consisted in the need: to modernize and diversify a traditional, dependent and crisis-ridden agricultural export economy; to deregulate the strong public sector and contain heavy state interference; and to reform the comprehensive but no longer affordable nor effective welfare state. At the same time, a new critical phenomenon had to be fought: growing misery and rapid impoverishment accelerated by military repression and excessive neoliberal experimentation, which produced 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 particular corporatist traditions of seeking consensus, moderate and incremental solutions and limited risk (traditions which have provided a level of stability and inclusion unequalled in Latin America), significant progress has been made since the 1980s. Non-traditional exports were increased, debts periodically re-negotiated, energy prices fell and many state-owned or state-controlled enterprises (*entes autónomos*) have been deregulated and privatized despite persistent resistance voiced in referenda in 1992 and in December 2003. During most of the 1990s, the economic growth rates wavered around 5%, and inflation and unemployment were contained to about 10% each. An approach of hesitancy and restraint however renders this positive trend less convincing.

Since the late 1990s, Uruguay has suffered the repercussions of the region's financial and debt crises. In 2002, Uruguay was thrown into its deepest recession of the 20th century, from which it did not begin to recover until 2003. During the first two years of the Vázquez presidency, Uruguay's recovery from this crisis has been much more visible than in the last years of his predecessor. Unemployment has gone down, farming, tourism and finance are doing comparatively well, foreign investment has gone up (though not enough), even in the new service industries, despite continued difficulties in overcoming restrictive conditions, such as the state-heavy traditions of public ownership and labor regulations, and the high Mercosur tariffs.

## Transformation Status

### I. Democracy

Since the early 1990s, Uruguay has again become a consolidated democracy based on the rule of law and embedded in a strong civil society with established channels for participation. There are no significant defects in crucial areas. The severe economic and social problems the country has been facing have not affected or delayed the successful return to democracy in a comparatively short period. The reforms of the electoral system of 1996 have also removed the initial weaknesses in institutional efficiency and legitimation. And while past administrations postponed confronting the historical and moral dimensions of crimes committed under the military regime, the Batlle (2000 – 2005) and Vázquez (2005 –) administrations have since addressed this legacy.

#### 1 | Stateness

Uruguay has no stateness problems. The state has a monopoly on the use of force, and has no competitors.

Monopoly on the use of force

There is a fundamental agreement on who qualifies as a citizen. All citizens have the same civic rights, and there is a fundamental acknowledgment of the constitution.

State identity

The state is defined as a secular order. Religious dogmas have no influence on politics or law. Church and state are separated.

No interference of religious dogmas

Uruguay has long-established differentiated administrative structures functional throughout the country and capable of implementing political decisions and allocating resources. The administrative system is sufficiently efficient, though in some areas rather traditional and in need of reform. Some evidence suggests that the Vázquez administration will address the issue of state and administrative reform more thoroughly than its predecessors.

Basic administration

## 2 | Political Participation

Rulers are determined by general, free and fair elections. There is effective universal suffrage, and elections are carried out appropriately.

Free and fair elections

The democratically elected rulers have the effective power to govern; there are no veto powers or political enclaves.

Effective power to govern

There is unrestricted freedom of association and assembly within the basic democratic order.

Association / assembly rights

Citizens, organizations and the mass media can express 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 still associated with political parties, although Uruguay's former lively scene with its broad variety of high-quality party political press shrank under authoritarian rule, 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.

Freedom of expression

## 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 each other's prerogatives. 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.

Separation of powers

The judiciary is traditionally independent, free from unconstitutional influence, differentiated and professionalized, although it may eventually suffer from lack of efficiency, particularly against street violence and organized crime, slow procedures, and the survival of some officials appointed by the authoritarian regime.

Independent judiciary

As a rule, corrupt officeholders are severely prosecuted under established laws. The passage of anti-drug legislation has increased anti-corruption measures, as has the Transparency Law (Ley Cristal) in 1998 by creating a Financial Investigations Unit, criminalizing a broad range of abuses of power by officeholders (including money laundering) and making financial disclosure statements compulsory for many officials. In March 2003, even the president of the association of public attorneys (1999 – 2001) was brought to trial for corruption. The Dirección General Impositiva (DGI) has also successfully fought

Prosecution of office abuse



tax and fiscal evasion and corruption under the leadership of the energetic Eduardo Zaindestat, one of the few top officials of the Batlle administration kept aboard by Vázquez (until 2007).

There are no restrictions on civil rights and human rights at present. Also, the new administration has regained the energy and momentum to address the human rights violations of the past military regime which had somewhat dwindled during the last years of the Batlle presidency. The government has stopped, and partially (although insufficiently) reversed attempts to obstruct all investigations beyond the 24 cases addressed in the Report of the Peace Commission of 2003, to bar due process of law of the military involved (in favor of “special” trials) and to grant impunity on the basis of limitation *ex ante*, even in spectacular cases. A number of former military officials have been brought to court (and foreign military extradited), and ex-President Bordaberry was finally imprisoned and held for a murder trial in November 2006. In May 2006, some of the leading generals of the authoritarian regime at least acknowledged their responsibility, partly in order to protect their subordinates.

Civil rights

#### 4 | Stability of Democratic Institutions

The democratic institutions work effectively and efficiently. As a rule, political decisions are prepared, made, implemented and reviewed in legitimate procedures by the appropriate authorities.

Performance of democratic institutions

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 in the military.

Commitment to democratic institutions

#### 5 | Political and Social Integration

The Uruguayan party system is moderate and relatively stable. Both traditional parties, the Colorados (liberal and conservative) and the Blancos (conservative and liberal), and their various factions and elites (often families) have been deeply anchored in society for more than a century. Furthermore, the system was able to integrate a substantial newcomer in the 1970s, also deeply rooted in society: the moderate leftist Frente Amplio coalition (FA, later EP-FA). This party remained stable with around 20% of the vote between the early 1970s and late 1980s, has successfully governed the city of Montevideo since 1990, gained a greater majority in the mid-90s (31% in 1994), and has become the strongest political force of the country since 1999. The integration of the former representatives of the underdogs, the excluded, the radicals and the ex-terrorists into the political system and the political class has been one of the greatest

Party system

pacifying achievements of the Uruguayan transformation. In December 2002, the EP-FA concluded an alliance with the smaller left-liberal Nuevo Espacio (NE) of Senator Michelini, which finally secured its electoral victory in 2004. While it was traditionally dominated by Communists, Ex-Tupamaros and various social democrats in the 1970s and 1980s, and later by Socialists (like Tabaré Vázquez), it has finally turned into a broad catch-all 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 once been a stronghold of the Blancos.

The level of fragmentation is low if we count the parties and not their traditional factions (*listas*), as is volatility, unless votes swing due to a disappointed public or there is a major gap in perception between the candidates and their programs, as was the case in the October 2004 elections. In these elections, President Batlle's Colorados lost more than 20 percentage points compared to the previous elections in 1999 (31.5 to 10.4) whereas the oppositional Frente Amplio and the Blancos who had left the coalition government a year before gained more than 12 points each (38.2 to 50.4 and 21.1 to 34.3 respectively). The results of the 2004 elections have produced a significant re-alignment and have changed the Uruguayan party system. While before 2004 the three parties each commanded roughly one-third of the vote, now the broadened Frente Amplio coalition represents about half of the electorate, and both traditional parties combined, the other half. In addition, the Colorados have reached the lowest point in their history. The alternatives have become clearer, reflecting the social cleavages.

A major (and indeed a secular) improvement has been the electoral reforms of 1996, which had been postponed during the transition. These reforms have decisively helped to streamline the party system, reduce fragmentation, and to broaden in particular the basis of the president's legitimacy. In the old system, the voters voted for the presidential candidates of the various factions within the parties, and the ticket with the highest plurality within the party that received a majority of votes took it all, so that the elected presidents usually did not have more than 15 to 20% of the total vote. The reforms introduced primaries and a run-off election between the two leading contenders (*ballotage*), which has contributed to more stable majorities and strengthened the mandate of the government. In the first presidential elections conducted according to the new rules (1999) this cost frontrunner Tabaré Vázquez of the Frente Amplio the victory, because most of the Blanco voters in the run-off voted one last time for Colorado veteran Batlle after their own candidate had been eliminated. In the run-off Batlle received 51.6%, and Vázquez 44.0% of the vote. The Frente finally triumphed in the 2004 elections due to severe disillusionment ("desencanto") over the disappointing balance of the Batlle government: the Colorado candidate Guillermo Stirling came in last (10.4%) behind the Blanco Jorge Larrañaga

(34.3%). Tabaré Vázquez, backed by a broad coalition (EP-FA-NM), made it to the presidency in the first round (50.4%), and the Frente coalition even won absolute majorities (also a new phenomenon) in both houses of parliament, coming in first not only in Montevideo (61.5%) but on average also in the departments of the interior (43%).

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 (partly corporatist) mechanisms of interest intermediation. There is a close-knit network of differentiated interest groups that cooperate, 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. The classics are the farmers' Federación Rural, some of its regional middle and small-size dissenters, a number of industrial and business associations, particularly the Cámara de Industrias del Uruguay (CIU), influential professional associations, and the strong and well organized labor unions which since 1964 have been coordinated in the Convención Nacional de Trabajadores (CNT, now PIT-CNT). Many of them have old traditions closely related to the early emergence of the Uruguayan welfare state now in crisis.

Interest groups

Support for democracy in Uruguay is the highest in Latin America, has been entrenched for long and does not essentially depend on the particular performance of the government, as it does in many other Latin American countries. It has remained high even in periods of heavy discontent and party realignment. Although according to Latinobarómetro data support has fallen from 84% in 2000 to 77% both in 2005 and 2006, satisfaction with the existing democracy has however regained its high score of more than 60% approval in 2005 and 2006 (vs. 69% in 2000), after a conspicuous fall in 2003 and 2004 (52%; 45%) due to the performance of the Batlle government. The authoritarian potential has even receded in crisis and on the whole remained constant at 10% (in 2001, 2005 and 2006), and only 33% of Uruguayans in 2004 said that they would tolerate 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 and democratic attitudes are secure and consolidated in Uruguay.

Consent to democratic norms

Uruguay has a strong civil society that has formed the backbone of its traditional democracy and has contributed much to the resistance to military rule (which has prompted the military to resort to extraordinary acts of repression) and to the relatively smooth transition and democratic consolidation. There is a close-knit web of autonomous, self-organized groups, associations and organizations, including well-organized groups protesting against human rights violations in prisons, the military regime's violation of human rights, or against maladministration of justice. But there are also groups formed by those who have

Associational activities

suffered at the hands of economic and social deregulation and restructuring in the last two decades, sinking into poverty and moving to the spreading slums surrounding Montevideo. Interpersonal trust, though it has fallen significantly lately, from 36% in 2002 to 24% in 2004, is still among the highest in Latin America.

## II. Market Economy

Uruguay has advanced its economic transformation since the mid-1980s and particularly in the 1990s. But progress has remained limited due to international constellations and markets, as well as the performance of its larger neighbors Brazil and Argentina. Until now, it has not yet found a sustainable basis. Since the late 1990s, Uruguay has suffered the repercussions of the financial and debt crises of the whole region (particularly Argentina), which inappropriate domestic reactions and inadequate temporary crisis management exacerbated, throwing Uruguay in 2002 into its deepest recession of the 20th century, from which it did not begin to recover until 2003. During the first two years of the Vázquez presidency, Uruguay's recovery from this crisis has been much more visible than in the last years of his predecessor. Unemployment has gone down, farming, tourism and finance are doing comparatively well, foreign investment has gone up (though not enough), even in the new service industries, despite continued difficulties in overcoming restrictive structural conditions, such as the state-heavy traditions of public ownership and labor regulations, and the high Mercosur tariffs.

### 6 | Level of Socioeconomic Development

Uruguay is not a typical “third world” country; indicators reflect a decades-long structural decline from earlier “first world” prosperity with all its legacies: a relatively high level of development for 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 due to 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 and 0.851 in 2004, and the GDI in 2004 (0.847) ranks equal with the HDI (rank 39). The UN Education Index stands at 0.95, and literacy is incrementally improving between 98 and 100%. Poverty, though it remains limited in comparison, has become a major problem since the waves of induced impoverishment that started in the 1970s and 1980s.

Socioeconomic  
barriers

This new phenomenon has persisted and even expanded, particularly during the recession of the late 1990s and early 2000s, and shows signs of becoming structurally imbedded. The absolute poverty ratio is below 2, but 5.7% of the population live on less than \$2 a day (1990 – 2004). The Gini coefficient indicates an increase in inequality between 1999 and 2003 from 42.3 to 44.9.

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	12,277	11,191	13,216	<b>16,791</b>
Growth of GDP	%	-11.0	2.2	11.8	<b>6.6</b>
Inflation (CPI)	%	14	19.4	9.2	<b>4.7</b>
Unemployment	%	17.0	16.8	-	-
Foreign direct investment	% of GDP	1.4	3.7	2.5	<b>4.2</b>
Export growth	%	-10.3	4.2	27.6	<b>16.8</b>
Import growth	%	-27.9	5.8	26.5	<b>8.8</b>
Current account balance	\$ mn.	322.2	-55.5	42.5	<b>-2.3</b>
Public debt	\$ mn.	6,683.7	7,094.2	7,437.6	<b>7,865.6</b>
External debt	\$ mn.	10,569.8	11,429.1	14,784.1	<b>14,551.4</b>
External debt service	% of GNI	10.5	8.2	12.2	<b>13.7</b>
Cash surplus or deficit	% of GDP	-4.9	-4.6	-2.5	<b>-1.6</b>
Tax Revenue	% of GDP	17.5	18.5	18.5	<b>18.5</b>
Government consumption	% of GDP	12.9	11.4	10.8	<b>11.2</b>
Public expnd. on edu.	% of GDP	2.6	2.2	-	-
Public expnd. on health	% of GDP	3.2	2.7	3.6	-
R&D expenditure	% of GDP	0.3	-	-	-
Military expenditure	% of GDP	1.7	1.5	1.2	<b>1.3</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | 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 (mostly infrastructure, energy and services) in order to promote development and secure the guarantees of the welfare state. Hence, the rules of the game 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. It has continued, though at a slow pace, due to the failure to attract potential investors, current crises and also to some reluctance on the side of the politicians and voters. In a 2003 initiative (which also served as a rehearsal for the 2004 electoral coalition of the left with the strong support of the labor unions) and a subsequent referendum held in December 2003, 62% of the voters rejected a 2002 law permitting joint ventures of the state-owned fuel, alcohol and cement corporation ANCAP with transnational companies. In October 2004, almost two thirds (64.6%) insisted that marketing of the country's water resources be barred by the constitution, and the majority voted a coalition into power that had campaigned against excessive privatization. There has, however, been significant continuity in the economic policies of the Batlle and Vázquez administrations. In its first two years in government, the Vázquez presidency has so far held a balance between the liberal convictions of Finance Minister Danilo Astori and some of the more interventionist demands of the socialists.

Market-based  
competition

There is legislation regulating monopolies and oligopolies, but it is not completely consistent, leaving loopholes and not addressing the public and public/private sector.

Anti-monopoly  
policy

Foreign trade has been liberalized, though there are still a number of fiscal import restrictions, and Uruguay, though not a member of the G-20, has been active in fighting U.S. and EU restrictions on agricultural trade. Uruguay is a member (and in 2003 served in the presidency) of the Mercosur and has contributed to a number of initiatives to enlarge and further integrate the free trade zones in Latin America. During the last two years in particular, the government has made efforts to criticize the protectionist tariffs and mechanisms of the Mercosur (from which the Uruguayan economy suffers), and instead seeks to form a closer affiliation and a Free Trade Agreement (FTA) with the United States. As these plans met with strong resistance from the Mercosur partners (now also including Venezuela) and from within the governing coalition, U.S.-Uruguayan

Liberalization of  
foreign trade

negotiations on a less ambitious Trade and Investment Framework Agreement (TIFA) began in October 2006. The agreement was signed in January 2007, but is still under pressure domestically.

Due to its location, political stability and liberal capitalist traditions Uruguay has long been one of the principal financial centers of Latin America, which has particularly attracted foreign capital and bank deposits from its neighbors often plagued by higher taxes and more intensive controls. The banking system and capital market are differentiated, internationally competitive and oriented to international standards, but they are vulnerable to severe fluctuations due to extreme dependence on outside factors and, especially, to lack of supervision, fraud and corruption, which have turned out to be widespread. During the severe fiscal, debt, currency and banking crises between 2001 and 2003 that hit the southern cone, the Uruguayan central bank and other authorities have not been able to aptly fulfill their supervisory functions and thus have reduced their future potential and credibility. In 2002, the growing recession, default and devaluation in Argentina (which led to freezing bank accounts) led to a string of crises including a run on Argentine accounts in Uruguayan banks, withdrawals en masse, organized fraud which ruined a big commercial bank, the spectacular reduction of foreign exchange in bank accounts and of almost all of the currency reserves and a resulting liquidity crisis that brought the financial system near collapse. 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 close them), cope with banking strikes and looting and freeze at least fixed dollar accounts temporarily in order to be able to re-open business with intensive IMF and U.S. assistance. The banking place Uruguay was saved at the cost of a dramatically increased foreign debt. Since 2004, conditions have improved, particularly in the course of further economic recovery during the last two years.

Banking system

## 8 | Currency and Price Stability

The government and the formally independent central bank try to keep inflation under control and to pursue appropriate exchange rate policies. But the institutional framework is inadequate and the goals cannot be consistently pursued over the required longer periods of time, due to extreme dependence on foreign influence and conjunctural volatility. In years of economic stability, the achievements have been impressive. During the 1990s the currency was stabilized for a longer period, and the annual rate of inflation went down considerably, to around and below 5 % in 2000 and 2001. The recession, the subsequent loss of monetary reserves and the deep monetary, fiscal and banking crisis triggered in 2002 a sharp devaluation of the peso against the dollar by almost 60% (followed by another 30% in 2003). It also triggered a new high in inflation of almost 26%, from which the country slowly began to recover by mid-2003 after new

Anti-inflation /  
forex policy

international credits had been placed and the foreign debts had been renegotiated once more. The average annual change in consumer price index for the period 1990 – 2004 was 23.9%, for the year 2003 – 2004 9.2%. During the last two years, inflation has gone up slightly, and in line with conjunctural indicators, from 4.9% in 2005 to 6.2% in 2006.

In fiscal and debt policy Uruguay undoubtedly has a “culture” of a policy of macroeconomic stability which it has demonstrated throughout the last two decades in a series of efforts to increase tax revenues, maintain austerity measures and make cuts in public expenditure, particularly in social services. Under the critical circumstances of economic contraction, lack of investment and rising unemployment, these cuts have contributed to an increase in poverty. The institutional safeguards have, however, been limited, and the country has once and again been drawn by “contagion” into the crises of the region, preventing it from reducing its budget deficit significantly. Under the impact of regional crises, the deficit went up from 3.5% of GDP in 2000 to between 4.5% and 5% from 2001 to 2003. In 2002 and 2003, the Batlle government only avoided insolvency and default by new credits, which it was able to mobilize thanks to its good relations with the United States (paid for by suspending diplomatic relations with Cuba) and the international financial institutions. These credits were successively granted and released in short sequence, often as stand-by credits, and in the end amounted to a total of about \$4 billion. Despite the fact that the rating agencies during these two years downgraded the country several times (which meant higher interest rates), Uruguay has, in comparison, been treated rather generously by donors who seem to have had more confidence in the Batlle government than the Uruguayans had, and often made it explicit that the country was not to be held directly responsible for its acute financial problems. The foreign debt has thus gone up from \$8.2 billion in 2000 to over \$10.5 billion in late 2003, roughly equaling 100% of GDP. In 2005 it amounted to near \$13.2 billion, about 85% of GDP according to the Economic Intelligence Unit (EIU). Since devaluation, in addition, had made servicing the increased debt nearly impossible and default was near, in spring 2003 Uruguay struck a complicated deal with the donors in order to reschedule the conditions of repayment by which maturity was essentially postponed to 2005 or 2010. Thus, the Batlle government succeeded in buying time and leaving the problems to its successor. The Vázquez government, contrary to voiced fears of its potentially populist spending inclination, has so far performed responsibly and professionally in renegotiating its debts and services with the IMF in June 2005 (i.e. a three-year credit of \$1.12 billion) and even made an early repayment of \$1 billion in November 2006, facilitated by excellent economic conditions, which substantially increased export volumes and prices. In July 2005 a loan of €300 million (for ten years) was launched (rated B3 by Moody’s, and B by S&P).

Macrostability



## 9 | Private Property

Uruguay has a liberal capitalist tradition, meaning that property rights and the rules regulating the acquisition, benefits, use and sale of property are well defined and usually safeguarded. Within the context of the latest financial crisis, there have been some problems of implementation with regard to a temporary freeze of foreign exchange bank accounts. These have been limited, however, to the short-term and have by far not approached the dimensions of the “corralito” in Argentina which President Battle, even under pressures from the IMF, explicitly refused to implement on the grounds of “preserving the political order.” Legal protection for investors (and incentives like tax breaks) has even been improved during the last years.

Property rights

Private enterprises are the norm, and the privatization of state enterprises has progressed since the 1980s, mostly for financial reasons, as in one of the most spectacular recent cases being the sale of the state airline PLUNA in 2002. A significant state sector still remains however, and privatization has slowed during the last years and continues to do so, as the outcome of the referenda in 2003 – 2004 (ANCAP, water), the program of the Frente Amplio and the announcements and actions of the Vázquez government have indicated. The cases of Petrosur and Telesur in 2005 and more recent moves have, however, shown that the government is increasingly following Brazilian models and joining in on multinational public/private ventures.

Private enterprise

## 10 | Welfare Regime

Uruguay has long been a traditional bureaucratic welfare state based on distribution at a very high level and built along the lines of European patterns, but for decades it has no longer been able to deliver, and the claims of the insured have been devalued. Like all traditional systems of social provision it needs comprehensive reform and restructuring in the light of demographic stagnation (Uruguay has the “oldest” population in Latin America) and rising rates of emigration of younger people, significant unemployment oscillating between 10 and 15% (2003 – 2006), an extended informal sector of an estimated 40% of the labor force (2003), and the need for more efficiency and equity. Particularly social security, unemployment and health insurance are in need of restructuring, and substantial cuts have to be made in the early retirement, pensions and benefit schemes of an overstuffed and privileged, though neither highly professionalized nor efficient civil service (with strong unions). The same is true of the military, which in 2003 attracted some attention thanks to the U.S. offer to include military pensions and health insurance in a large military aid package. In the last two years, reforms have been initiated with more imagination and decision than

Social safety nets

before: social security has been privatized in parts, public health costs have been reduced and many benefits have been cut. But the system still needs restructuring. Most of the Banco de Previsión Social budget is still allocated for pensions and unemployment benefits and must be increasingly subsidized by the state because the contributions of the insured have receded during periods of high unemployment and informality. On the whole, Uruguay still has the highest spending on social protection in Latin America (more than 20% of GDP as compared to an average of about 5%). The increase in poverty, which was accelerated by the crisis of 2001 – 2003, has also grown formidable. In late 2002, the state had to feed about 50,000 of the nation's poorest on a daily basis (INDA), and UNDP estimates that about a quarter of Uruguay's pregnant women and 13% of children under five suffer from malnutrition. In March 2005, the Vázquez government launched an emergency plan against poverty (Plan de Atención Nacional de Emergencia Social) and extra funds particularly focusing on food, health, family benefits for the unemployed and poor, and education in problem areas. The plan makes use of the available resources, particularly in the health sector, and combines the traditional mechanisms of unemployment insurance and welfare benefits for the needy with new requirements of the "workfare" type à la Wisconsin. Its additional costs have been calculated at around \$100 million. After a year in office in March 2006, the government, due to higher growth and tax revenues, agreed to higher salaries and set aside additional funds for social programs, particularly for the 350,000 poorest Uruguayans. By July of the same year, however, labor disputes began to rise in the conflict over the negotiations in the tripartite wage councils (Consejos de Salarios) for the private sector.

Equality of opportunity exists in principle, even if the level has been deteriorating for some time and the presence of marginality and poverty has reached a critical limit. There are a number of institutions, traditional and new, to compensate for gross social differences, and the new government's emergency program has intensified their activities. Women have equal access to education, public office, etc. The female rates as per cent of the male rates in adult and youth literacy in 2002 were 101%; the ratios of female to male enrollment in primary, secondary and tertiary education in 2000/01 were 1.01, 1.11 and 1.82. The ratio of estimated female to male earned income in 2004 was 0.55; the GDI was 0.847 (rank 39), the GEM 0.513 (rank 50).

Equal opportunity

## 11 | Economic Performance

Despite its many ongoing structural problems (among them high external debt, insufficiently diversified export structure, volatility of capital and tourism, corporatist and bureaucratic traditions, contained deregulation, dependence on the economic performance of its bigger neighbors) Uruguay has, under the Vázquez

Output strength

government, substantially recovered from the impact of the Argentine crisis and from the blockades of the Batlle administration. During the first two years of the Vázquez presidency, Uruguay's recovery from this crisis has been much more visible than in the last years of his predecessor. Unemployment has gone down, farming, tourism and finance are doing comparatively well, foreign investment has gone up (though not enough), even in the new service industries, despite continued difficulties in overcoming structural restrictions, such as the state-heavy traditions of public ownership and labor regulations, and the high Mercosur tariffs.

## 12 | Sustainability

Environmentally compatible growth has been taken into account in important portions of economic life. Environmental concerns are effectively addressed in many sectors that depend upon them, e.g. modern stockbreeding, wine production and tourism. But on the whole ecological concerns tend to be subordinated to efforts to promote growth, which still is considered to be the principal economic goal. Rural out-migration, increased poverty and extending slum settlements around Montevideo have also limited the chances for a better environment. Reluctance and resistance to modernize a number of key state enterprises in the energy sector through public/private partnership also frustrated the environmental cause. A key issue of transnational "environmental" conflict from 2005 through early 2007 have been the plans of Finnish investor Metsa-Botnia to construct a paper mill on the Uruguay river near Fray Bentos on the border with Argentina (initially there was another case involving the Spanish ENCE) against which Argentine and international environmental activists mobilized blockades and violent protests. After the International Court of Justice had twice ruled for the factories to be built in July 2006, the Spanish investor canceled its project, and the plans of the Finnish company (a \$1.7 billion investment, or about 1.5 percentage points of the growth rate) were delayed under continuing protests, despite the fact that a World Bank study had declared the environmental impact of the plants as minimal. Meanwhile the conflict has developed into a full-fledged crisis between the two countries.

Environmental  
policy

Modern infrastructure exists in principle, but still needs modernization. Uruguay has a solid and differentiated system of primary and secondary education, which has, however, suffered acutely from budget cuts, lack of discipline and reduced efficiency in recent years. According to an official report in October 2003 the number of effective classroom hours of secondary students in Uruguay has been by 50 to 65% lower than in comparable schools of Spain, France or Great Britain. The traditional, still overwhelmingly public tertiary sector, due to its lack of sufficiently professionalized M.A. and Ph.D. programs in many areas, is not yet

Education policy  
/ R&D

internationally competitive and lacks sufficient funding. This is particularly true for the institutions of advanced studies, research and development, where the impact of the catastrophic scientific brain drain triggered by the military regime is still being felt. New curricula, individual reforms and a debate on the needs and shape of educational reform have, however, been underway during the last years, and competition from private universities has begun. According to UNDP public expenditure on education in 2002 – 2004 was lower than in 1995 –1997 or in 1990 (2.2 : 3.3 : 3.0% of GDP). Its share in total government expenditure has dropped from 16.6% in 1991 to 7.9% in 2002 – 2004. R&D expenditures in 2000 – 2003 reached only 0.3% of GDP.

# Transformation Management

## I. Level of Difficulty

On the whole, the structural constraints on governance are moderate in Uruguay, at least in comparison to the rest of Latin America, or of the world. The country is small, homogeneous, Western, rich in agricultural resources, possesses all the institutions as well as a long institutional and behavioral tradition of democracy and 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 economic performance of its larger neighbors and from its high debt, which makes Uruguay additionally dependent on the United States and the international financial institutions. Thus, room for maneuver often has been narrow, particularly during the country's greatest recession and financial crisis of the century in 2002 – 2003 and its aftermath.

Structural  
constraints

As it has been stated above in more detail, Uruguay has strong, differentiated and long institutionalized traditions of a civil society and a developed participatory civic culture which has been conducive to democracy and long periods of social peace. Trust in institutions and social trust have, however, suffered a bit lately due to the perceived processes of rapid downward mobility, marginalization and impoverishment (even of segments of the middle classes) as a consequence of dictatorship, neoliberal reforms, unemployment and the economic and financial crisis.

Civil society  
traditions

There are no significant ethnic or religious cleavages and conflicts. Social cleavages and conflicts have been increasing since the days of military rule, which has led to a more clearly marked division between the (still) established society represented by the Colorado and the Blanco Parties, and the underdogs or "outs" represented by the Frente Amplio coalition. The cleavages are not, however, irreconcilable, but rather depend on economic and political performance. And the fact that the Frente Amplio has been governing the country since 2005 has signaled that cleavage constellations may be changing again.

Conflict intensity

## II. Management Performance

The quality of political management and governance in Uruguay has not changed significantly during the last two years despite a number of minor, but still noteworthy improvements. The end of the legislative gridlock has made policies slightly easier to implement and coordinate, although the heterogeneity of the broad Frente coalition still necessitates time-consuming negotiations within the governing majority.

### 14 | Steering Capability

During the period under review the political leadership has been committed to constitutional democracy and socially responsible market economy. Their policies have given these goals priority over short-term expediency with more success than the Batlle government. Whereas Batlle followed his course of stability, austerity, budget and debt consolidation, administrative reform, privatization and economic restructuring even at the risk of gridlock and isolation, President Vázquez has managed to organize broader support for his priorities in favor of more social responsibility, a war on poverty, a more active role of the state in promoting national industry, more public-private partnership programs à la Brasileira, as well as tax, health and administrative reforms. It helped that he revealed his openness to compromise from the beginning when he named, at an early stage in July 2004, moderate Senator Danilo Astori, one of Uruguay's brightest economists and a reformer who had criticized the earlier economic program of the Frente coalition, to be his minister of finance and economy. Astori is still the strongest member of the cabinet and an important factor in its stability (a new phenomenon after many years of ministerial resignations). In October and November 2006, under pressure from the ruling coalition, the government had to cut back its plans for a Free Trade Agreement (FTA) with the United States and embark on negotiations of a slimmer "framework agreement", TIFA. The government's approval rate had fallen from 53% (March 2005) to 37% (and the popularity of the president from 69 to 49%), but it remained strong and capable of leadership nevertheless. In December 2006, it managed to steer a complex and somewhat controversial tax reform bill through both houses of parliament.

Prioritization

The government cannot implement all of its reforms effectively because it must always seek a compromise between the different sectors of the coalition, particularly the more liberal factions on the one hand, and the moderate Socialists and the unions on the other, and also because it must still work

Implementation

through the existing administrative and bureaucratic structures. However, its balance in the last two years has been much better than the balance of the preceding government, which ended in gridlock. It has passed important legislation on various issues (see above), and the hands-on presidential office has tried, up to a point, to streamline government. Some of the “bigger” reform agendas will obviously need more time but were, in early 2007, at the forefront of debate and partly operationalized, including the reform of the state bureaucracy (*reforma del estado*), pilot public-private partnership operations on railway infrastructure and freight transportation services, and health reform, which has been launched incrementally and is still conflictive.

The political leadership’s capabilities in policy innovation and learning have, on the whole, remained unchanged (and mixed), but for different reason, and with the learners and non-learners in different functions. In the last two years of the Batlle administration (until early 2005) the government demonstrated that despite continuing achievements (e.g., Economic Minister Alejandro Atchugarry’s deregulation), it was no longer capable of learning and reacting flexibly and productively to the political process. The opposition was, despite its many problems, particularly the EP-FA leadership to a remarkable and unexpected degree, as were the Blancos and some Colorado groups not represented in government. Since the takeover of the Vázquez administration, these differences have continued more or less, but now the various groups have assumed different functions: the Frente coalition leadership continued to be capable of learning even in government, and the Batlle faction (*lista 15*) continued not to be, even in opposition. So when Batlle, instead of looking out for common ground and consensus on the more important reform projects, stuck to populist rhetoric and, in December 2006, called the government “fascist.”

Policy learning

## 15 | Resource Efficiency

In the last two years, the use of the available economic and human resources by the government has improved somewhat from the two years before. But the balance is still rather mixed, as some of the reforms, particularly affecting resource efficiency, have been moving slowly. The Vázquez government, in December 2006, finally overcame the obstruction of many groups (including from its own ranks) and succeeded in passing long-delayed general legislation on tax reform, introducing an income tax for which the IMF had long advocated. The budget deficit and the debt are still relatively high, transparency of the budget has been improved, as has auditing (SEV) and controlling (SIIF) in some areas of public administration, but not overall. Controls and regulation are still lacking in substantial sectors of public administration, which have been outsourced and privatized (often with the same personnel at better salaries), even

Efficient use of assets

if the present government has tried to contain these processes. The quality, efficiency and effectiveness of public administration have been improved only in some sectors; it is still overstaffed, and personnel costs are too high. The year-long practice of hiring short-term employees (asesores), not too often from the respective professional elites in transparent and open competition, instead of permanent civil servants (whose posts were abolished for the record), seems to have declined in 2007, but problems remain. So far, plans for decentralization have not advanced much. But at least the comprehensive reform of public administration (Reforma del Estado), which after its launching by Sanguinetti in 1995, moved slowly with often counterproductive results, torn between fashionable “New Public Management” ideas (unimaginatively followed by the book) and traditional waste and gridlock, has regained momentum since the Vázquez administration took over in early 2005 and placed more imaginative experts (and critics of the reform’s past performance) in high executive posts.

The government’s capability to coordinate conflicting interests and objectives into a coherent policy has significantly improved under the Vázquez government, which has exercised leadership with more resolve than Batlle could during his last years. There are fewer conflicts within the government, fewer resignations, redundancies and lacunae and fewer blockades. The difficult task of mediating and balancing between the various factions and groups of the governing coalition remains however, particularly between the administrative and professional elites, mostly liberal with a leftist tendency, and the Socialists and labor unions of the PIT-CNT. Over time, open labor conflicts have emerged (e.g., with the lorry and taxi drivers in October 2006). In a number of matters, mediation and compromise have required time, and in others progress has been merely incremental. However, compared to preceding years, it has been progress nonetheless.

Policy coordination

In the period under review the government has continued to fight and successfully curb corruption. Most of the traditional and new integrity mechanisms (see above 3.3) have been functioning; scandals have been reported.

Anti-corruption policy

## 16 | Consensus-Building

All significant political actors in Uruguay have agreed since 1985 on building and extending a 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 a century. Its traditional democracy always has tended toward consensus or consociational democracy with a number of corporatist arrangements. Moderation, compromise, generalized capacity to form coalitions and the search for consensus on (often incremental) reformist projects have characterized the course of traditional Uruguayan politics. Most presidents have

Consensus on goals



appointed members of various parties and factions, including the opposition, to the cabinet or other high office (from which they usually resigned shortly before the following elections). The integration of the civilized 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 took time. Even the more accentuated marginalization and social polarization along the lines of those who won and lost during the last decades (particularly since the most recent crisis) and the subsequent party realignment before and during the 2004 elections have not 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, in pursuing plans to privatize basic services and energy, cutting too much in the social and health sector, introducing drastic changes to taxation, terminating the debates on the crimes of the military regime, or ally too closely with the United States, a consensus-seeking political society either ignored it or voted it down. The more cautious approach of the Vázquez government has, on the whole, been more successful, notwithstanding a few similar experiences of containment or resistance (from the government's own ranks), such as concerning the intended closer trade alliance with the United States (FTA), which the government has had to dilute.

There are no significant anti-democratic veto actors in Uruguay, and the reformers usually can even co-opt most of their democratic competitors pursuing slightly different strategies and priorities.

Anti-democratic veto actors

The political leadership generally succeeds in managing political cleavages so that they do not escalate into irreconcilable conflicts; social conflicts have not become irreconcilable so far in Uruguay. The Vázquez government has, in fact, done much better than its predecessor in moderating its demands and programs, mediating between divergent interests, broadening its coalition, addressing and avoiding the dangers of polarization, and building bridges.

Cleavage / conflict management

Political leadership in Uruguay, on average, cannot but assign a key role to civil society actors in deliberating and determining policies. Civil society traditions have been deeply entrenched for nearly a century in Uruguayan politics, political parties, factions and interest organizations. Neither repressive military rule nor weak or inconsistent leadership by democratic politicians has yet been able to substantially damage them.

Civil society participation

The political leadership has made substantial efforts toward reconciliation for historical acts of injustice (see above 3.4). From 2005 on, the Vázquez government has mobilized new energies to restore momentum to address the human rights violations under the past military regime, which had dwindled during the last years of the Batlle presidency. The government has stopped, and

Reconciliation

partially (although insufficiently) reversed attempts to obstruct all investigations beyond the 24 cases addressed in the Report of the Peace Commission of 2003, to bar due process of law of the military involved (in favor of “special” trials) and to grant impunity on the basis of limitation *ex ante*, even in spectacular cases. A number of former military officials have been brought to court (and foreign military extradited), and ex-President Bordaberry was finally imprisoned and held for a murder trial in November 2006. In May 2006, some of the leading generals of the authoritarian regime acknowledged their responsibility, partly in order to protect their subordinates.

## 17 | International Cooperation

Uruguay is a small, highly dependent, risk prone, impoverished and indebted country which cannot but closely cooperate with the international financial institutions and bilateral donors. There is broad consensus on this within the political elites, even if they may differ slightly in nuance, and some factions of the EP-FA may eventually criticize globalization, neoliberalism and U.S. or IMF “dictatorship.” Uruguayan political leadership has made well-focused use of international assistance for the needs of the country’s economic and structural transformation, domestic policy agenda, infrastructural and educational programs, for fighting poverty and promoting research and development.

Effective use of support

In the last two years, the international community has considered the government to be a credible and reliable partner. The country’s good standing, which has not been significantly affected by the change in government, has been acquired by a sequence of governments since the 1980s, and particularly owes to the fact that Uruguay, in contrast to Argentina, has avoided default and bankruptcy and succeeded in renegotiating its debts in time, even under the pressures of severe crisis (such as between 2002 and 2004). Nuances do exist: for example, the Batlle government supported the Bush administration’s unilateral international moves and broke with Cuba, whereas the Vázquez government has voiced more criticism of the United States and, as its first diplomatic act, restored relations with Cuba. Both, however, have aspired to a closer economic relationship with the United States, and both have been criticized for that domestically. The country’s S&P currency rating has moved from B/Stable/B in 2005 to B/Positive/B in 2006.

Credibility

Uruguay’s political leadership has continually demonstrated its willingness to cooperate with neighboring countries in regional and international organizations. It has built and expanded successfully as many cooperative international relationships as possible and promoted regional and international integration. Uruguay is a member of the Mercosur, has served in its presidency and contributed to its organization and infrastructure. It also has promoted free trade

Regional cooperation

agreements with Mexico, Peru and the Andean Community, and supported the plans for a Latin American customs union, better currency coordination, and more openness, usually in a push-and-pull alliance with Brazil. Efforts of the Batlle and Vázquez governments to achieve a free trade agreement with the United States have however provoked domestic opposition and resistance from the Mercosur partners. President Vázquez has been more outspoken than his predecessor when, during the last two years, he has repeatedly criticized the Mercosur for its protectionist tariffs and trade-containing mechanisms from which the Uruguayan economy is suffering. However, Uruguay has so far not made any realistic move to modify the conditions of association or to leave the group altogether. The president, unlike his predecessor, has also avoided making inflammatory or insulting speeches about Argentina or his Argentine colleague. Relations might even have improved, had not a new controversy produced an escalation of conflict with Argentina: the violent Argentine protests and legal procedures against the construction of two paper mills on the Uruguay river near Fray Bentos on the border with Argentina, the biggest private investment ever in the country (see above 12.1). The crisis has continued to escalate, due to insufficient crisis management on both sides. It has damaged Uruguayan tourism and trade, the reputation and political alliance of the two countries and (perhaps terminally) the mechanisms of the Mercosur. Argentina has insisted that the issue is a bilateral one, has not complied with international court orders and has vetoed Mercosur or third party mediation offers. So far even the latest negotiations between the two countries have remained fruitless. In April 2007, the two delegations parted in Madrid without any agreement but to meet again within a month. It is obvious that Argentine President Kirchner wants to keep the conflict alive in order to instrumentalize it for populist rhetoric in his upcoming election campaign.

## Strategic Outlook

The new government under Tabaré Vázquez was able to avoid a genuine test of its governance in the last two years thanks to Uruguay's extraordinarily strong economic performance. Unemployment has gone down, farming, tourism and finance are doing comparatively well, foreign investment has gone up (though not enough) even in the new service industries, despite the structural legacies of the past and the limitations of the Mercosur. The Vázquez government, which has demonstrated greater resolve and leadership than its predecessor, can build on a substantial amount of international and domestic trust. Disillusionment has set in certain sectors only; it has been incremental and arises at specific moments, such as during conflicts with labor unions or professional groups over tax reform, health insurance, education or state reform. How long disillusionment can be contained will again depend on the performance of the economy.

Major problems remain, and many reforms have moved significantly slower than expected, not least due to resistance from within the governing coalition and the need for continued mediation. This applies to the wars on poverty, unemployment and corruption, to the reform of the oversized welfare state, as well as to the fight for a balanced budget, more tax equity, health care and educational reforms, infrastructural innovation and the promotion of competitive manufacturing and service industries (requiring capital), administrative efficiency, decentralization and more extended participation. Here again much will depend on the ability of the government and the political elite to compromise and mediate, balance market incentives and social responsibility and modernize the country with common sense and sufficient institutional imagination.

Keystones in this transformation will be the negotiations on public/private partnerships and joint ventures in infrastructural and other formerly state-heavy domains, the attraction of foreign capital, further steps in tax and state reforms and in overhauling the welfare mechanisms and the development of adequate tertiary education and research institutions. Uruguay's potential positioning within (and the respective organizational reforms of) the Mercosur and the country's economic and trade relationship with the United States will also influence this process. Greater economic as well as political damage could also result from the yet unresolved and uncontained conflict with Argentina over the construction of the paper mill(s) on the Rio Uruguay, if the two countries do not come to a settlement soon.