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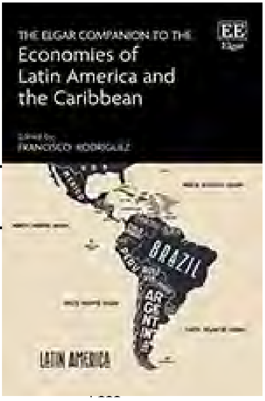
THE ELGAR COMPANION TO THE
Economies of
Latin America and
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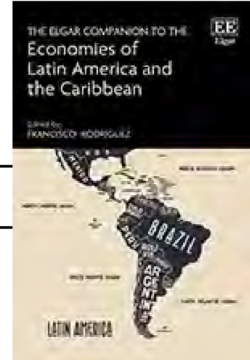
BRAZIL
LATIN AMERICA

Contents



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29. Uruguay: a tale of economic successes and failures

Arturo C. Porzecanski and Henry Willebald

INTRODUCTION

Uruguay has long stood out in regional comparisons as being among the most prosperous, homogeneous, progressive, egalitarian, nonviolent, and democratic countries. Though deprived of mineral and hydrocarbon wealth, it is endowed with a temperate climate, watered arable pastures, permanent grasslands, rolling hills, and access to rivers and the Atlantic.

Much of the country's economic future is derived from a prescient decision taken by Fernando Arias in the early 1600s. The first native-born Spanish governor of the region, he allegedly sent 100 head of cattle and 100 horses and mares from a northwest location to the empty territory that became Uruguay. There they were left to run wild and multiply, which they did prolifically, such that by the end of that century, wranglers and merchants mainly from would-be Argentina had settled in the territory to hunt the animals and process their hides and tallow for export (Pendle 1963).

Abundant livestock thus became the backbone of Uruguay's fledgling economy during the 1800s and early 1900s, especially once shipboard refrigeration enabled the export of fresh carcasses, and not merely salted and canned beef, plus hides and sheep wool. However, in the wake of a large wave of mostly European immigration, which quadrupled Uruguay's population to over one million by 1910 relative to 1860, governments became increasingly activist in promoting businesses that would create jobs—especially in the capital city, where the migrants tended to settle. This led to the establishment of small-scale industries through protectionism, the setting up of state-owned entities to address developmental bottlenecks, and government provision of most essential services such as public utilities, education, and healthcare.

Fast forward to recent years, and commodities and processed goods of agricultural origin still generate between 85% and 90% of Uruguay's merchandise export earnings (Uruguay XXI 2024).[1] Nevertheless, most economic activity and employment involve the provision of services, mostly to locals but increasingly also to foreigners who vacation, invest, and contract for professional, financial, and technology services in Uruguay, such that they too bring in dollars. And yet, while the population enjoys a relatively high standard of living, it could have fared much better.

Income inequality has historically been lesser in Uruguay than elsewhere in the region (Prados de la Escosura 2005), based on its peculiar colonial heritage, resource endowment, and institutional factors (Rodríguez Weber 2024). No powerful aristocracy like those in New Spain, Lima, or even Buenos Aires or Santiago ever developed, of the type highlighted by influential authors (Engerman and Sokoloff 1997; Acemoglu, Johnson, and Robinson 2005). Especially so prior to the 1870s, land was abundant, and workers were scarce, supporting relatively high returns to labor. It was only from the 1870s until the 1920s that the distribution of income worsened in the wake of mass immigration and the expansion of international trade (Lezama and Willebald 2020). Since the 1930s, however, the trend was reversed following the introduction of labor-friendly laws and protectionist trade policies.

HISTORICAL CONTEXT

In the 16th and 17th centuries, the River Plate was not a commercially attractive region: it was distantly located in the far south of the Spanish Empire and lacked lucrative natural resources like spices and precious metals. After Uruguay's first constitution was adopted in 1830, the nation was plagued by decades of political instability, civil war, ineffectual institutions, and economic backwardness.

It was solely during the 1870s, and especially under the leadership of Colonel Lorenzo Latorre (1876–80), that basic laws and institutional reforms were enacted, such as providing for a professional judiciary and free, compulsory public schooling, as well as mandating that landholdings be duly registered and fenced, and cattle be branded in order to minimize property disputes (Barrán and Nahum 1967). With the benefit of hindsight, Latorre's greatest accomplishment was to provide Uruguay with what was necessary to encourage livestock production and exports on a large scale (Finch 1981). Indeed, export earnings almost doubled between the late 1870s and the late 1890s (Díaz 2003).

At the time, waves of European immigrants were arriving and settling in the capital city of Montevideo, with few of them becoming farmers or finding employment in the countryside. And yet, despite the absence of factories other than to process livestock, Uruguay had already achieved levels of output per capita very close to countries such as Britain, France, Germany, and the United States (Bolt et al. 2018) and it seemed prepared for a promising future (Foreman-Peck 1995).

The thrust of economic policy in early Uruguay was typical 19th-century liberalism, except when it came to foreign trade, which was viewed as a source of much-needed tax revenue and increasingly as a means to spur industrialization. A turning point in terms of protectionism occurred in 1875 when a new customs law with a mercantilist bent was adopted, followed by another in 1886 whereby certain imports were subjected to high tariffs, and then by an 1888 modification that replaced ad valorem tariffs with specific duties (by volume) with clear protectionist intent—to encourage a diversification of national production (Favaro and Sapelli 1989).

In the early 1900s, wool, hides, and leather were exported mainly to Europe, and salted beef to Brazil and Cuba. In 1911, refrigerated beef started to be shipped abroad. On the eve of World War I, Uruguay ranked fourth in Latin America in terms of exports per inhabitant (Bértola and Ocampo 2012).

On the political front, the most notable event was the election, and later reelection, of President José Batlle y Ordoñez (1903–1907 and 1911–1915), a visionary reformist who came to dominate the political scene until his death in 1929—and decades beyond. Inspired by reading European philosophers and by having lived in Europe, Batlle developed a belief, later enshrined as *Batllismo*, that the state should lead the development process and that it ought to protect workers and ensure social justice. Therefore, he pursued initiatives that ranged from nationalizing the largest commercial and mortgage banks then in existence to founding two state-owned monopolies, one over electric energy and the other to underwrite insurance;

spending on public works projects—from building highways and bridges to public hospitals, middle schools, and an enlarged state university; and ensuring passage of laws providing for maternity leave, divorce (even if sought by women), pensions for civil servants, an 8-hour workday, and compensation for workplace accidents (Finch 1981). It was the beginning of what could be called Latin America's first social state—because it never became a European-style welfare state (Filgueira 1995).

Battle's legacy would drive his successors further in the direction of state intervention in economic and social affairs, especially to encourage job creation (mostly in Montevideo) and improve workers' rights through labor unions, as well as legislation, e.g., mandating that pay raises be set by wage councils in which workers, business owners, and the government would be represented. While Battle and *Batllismo* were hostile to the foreign (mostly British) companies that owned slaughterhouses and meat-packing plants, as well as public utilities, and most were eventually nationalized, it never advocated a land reform that would expropriate and break up spacious cattle ranches to benefit tenants or would-be farmers. However, it was consistent with a whole host of direct and indirect discriminatory trade, fiscal, credit, and exchange-rate policies that were rolled out during the first half of the 20th century. They rewarded new farming, manufacturing, and a variety of services while penalizing the livestock industry, in particular (Rama 1991; Bertino et al. 2005).

Fiscal and monetary policies were managed conservatively from the 1860s through the 1920s. Uruguay adhered to the international gold standard from 1876 through 1914, but even before then, gold and silver backed all currency in circulation. As a result, the binding commitment imposed by fixed exchange rates to those metals greatly constrained fiscal and monetary leeway (Díaz 2023). Uruguay never went back on the gold standard after the end of World War I, but fiscal and monetary affairs were nonetheless initially managed responsibly because the authorities did not want to undermine the Uruguayan peso: it averaged 0.98 pesos to the dollar during the 1900s, 0.96 during the 1910s, and 1.14 during the 1920s. For example, while modest fiscal deficits were registered during 1915–1923, modest fiscal surpluses were recorded during 1924–1929 (Caetano and Rilla 2004).

As was the case in most other South American countries, however, the Great Depression and the definitive end of the gold standard provided an impetus for new or preexisting policies that encouraged self-sufficiency via import-substituting industrialization and agricultural diversification. It also opened the door to looser exchange-rate commitments and thus laxer fiscal and monetary policies.

In Uruguay, the peso stopped having a clear and simple exchange value after 1931 because a regime featuring multiple exchange rates came into effect. There was a stronger official exchange rate for commercial transactions that was set by the authorities; a weaker market-driven exchange rate that applied to financial transactions; and a blended rate that the government set somewhere in the middle of the prior two. From the 1930s until the early 1970s, this currency regime was managed for protectionist purposes. For example, exports of fruits and vegetables earned 100% of the more advantageous blended rate, because the government wanted to encourage them. On the other hand, exports of hides received just 20% of the blended rate, plus 80% of the disadvantageous official rate—because the government wanted to discourage them (Díaz 2003). A similar discrimination applied to imports, with dollars for consumer goods priced much higher than for machinery and equipment imports.

The muddled exchange rate regime allowed for looser fiscal and monetary policies, which in turn undermined the peso's value. During the 28-year period from 1930 to 1958, the fiscal accounts registered chronic deficits except in the 6 years 1935-38 and 1947–48. This reflected an evolution of the role of fiscal policy in which expenditures and revenues became a means to speed up the development process and to improve the distribution of income, such that fiscal outcomes were subordinated to those objectives rather than to financial stability (Azar et al. 2008). The official cost of a dollar, which had averaged 2.20 pesos during the 1930s and 2.10 in the 1940s, doubled to 4.21 in the 1950s. By 1959, a dollar in the official market sold for 10.33 pesos (Caetano and Rilla 2004).

The leading economic and social indicators reflected Uruguay's positive developmental evolution, but one downside of government policies was that while in the 1920s Uruguay was a relatively open economy, with an openness coefficient (exports plus imports relative to GDP) of over 25%, toward the end of the 1950s this share had declined to near 20%. Moreover, during the 1870–1955 period, economic growth had been driven by the more extensive use of land, labor, and capital, but the estimates for total factor productivity were consistently negative, revealing a disappointing loss of efficiency during the protectionist decades (Hofman and Valderrama 2021). Worse yet, the ill effects of expansionary fiscal and monetary policies were now clearly visible: the economy was stagnating and facing major macroeconomic disequilibria, as evidenced by accelerating inflation and plunging currency values (Oddone 2010).

Behind the swings in economic policy and resource allocation were power struggles. During most of the 19th century, the confrontation involved landowners versus a Montevideo-based elite of international traders, shippers, and bankers. The former advocated for greater access to bank credit at low interest rates to enable them to buy more property and raise more cattle and crops. The latter lobbied for a stable currency backed by gold, fiscal discipline, and minimal taxes and restrictions on international trade, so they could prosper—and their interests largely prevailed (Barrán and Nahum 1971). During most of the 20th century, the conflict evolved such that landowners were now pitted against Montevideo-based entrepreneurs and immigrant labor. The workers gained political influence given their growing numbers and unionization possibilities, and they were highly motivated by their need for jobs and business opportunities. Together with native-born workers and businessmen, they combined to advocate for protectionist policies that fostered domestic manufacturing and higher wages and benefits—and they were politically successful throughout most of the 20th century (Connolly and de Melo 1994; Rama 1993).

1955–1990: A MOSTLY VICIOUS CYCLE

During the mid-1950s, Uruguay entered what would become a 35-year period marred by multiple recessions and mostly brief recovery cycles; permissive fiscal and monetary policies needing periodic restraining; episodes of high and variable inflation with damaging economic, social, and political consequences; and a series of disruptive banking, currency and debt crises.[2]

During 1955–1990, the annual inflation rate averaged in excess of 50%, and the yearly compounded real GDP per capita growth rate was an anemic 0.6%.[3] As a result, whereas during the 1930s, and even the early 1950s, Uruguay's PPP-adjusted per capita income was around 60% of New Zealand's, an economically similar nation to which it has often been compared (Schlueter 2014), by the late 1980s Uruguay's per capita income had fallen behind to a level about 45% of New Zealand's.[4]

Although the precipitating factor for this mostly vicious economic cycle was a drop in foreign demand for Uruguay's agricultural exports after the end of the Korean War, its underlying causes were more complex. The foremost culprit was government policies which, since the 1930s, had discouraged producers of wool, beef and hides—the country's main U.S. dollar-earning crops—while encouraging uncompetitive import-substituting, light manufacturing and new agricultural crops (e.g., sunflower, fruits, and vegetables) to meet the needs of domestic consumers. By the mid-1950s, livestock and other exports were no longer generating enough dollars to satisfy the growing import needs of consumers and businesses. Whereas during 1935–40 Uruguay exported 42% of its beef production, by 1959–1964 only 28% was exported (Brannon 1969). Total merchandise exports peaked at $270 million in 1953, dropped below $200 million during 1957–1968, and did not reach their 1953 level until two decades later (IMF 1953–1973).

A discriminatory system of multiple exchange rates for exports and imports was in effect from 1931 until 1959. Dollars earned by ranchers were redeemable for fewer pesos than other exporters received, while dollars needed to import inputs for their use, such as tractors and fertilizers, were available for more pesos than other producers had to pay. The net effect was to tax livestock owners' output as well as their inputs, thus undermining their profitability (Griffin 1974).

In addition, the livestock industry was penalized when selling domestically, because prices paid for beef destined for Montevideo, where over 40% of the population resided, were set low by a state-owned slaughterhouse monopoly as part of a scheme to subsidize domestic beef consumption (Brannon 1971).

Simultaneously, consumer goods' imports were restricted by stringent quotas and by overcharging for access to dollars, while manufacturing firms, many of which were state or private monopolies, were undercharged for the dollars they needed to import intermediate and capital goods—a double protectionist benefit (Griffin 1974).

Uruguay's currency and foreign trade regime underwent several transformations. In 1959, multiple rates were ditched and thereafter the currency had a single exchange value set by the authorities that was adjusted from time to time—always downward, given galloping inflation. Most quantitative restrictions on trade were removed, though they were replaced by an equivalent system of export taxes and import surcharges, such that livestock producers were again penalized while manufacturing firms were favored (Connolly and de Melo 1994). Yet at least exporters were free to sell, and importers were free to buy, however many dollars they wished for commercial transactions—as long as the applicable taxes and surcharges were paid.

In 1964, export taxes and import subsidies made a comeback. Taxes were again levied on sales abroad of wool, beef and hides, while manufacturing firms got subsidies of up to 20% on their exports and were relieved of import duties on inputs used in export production (Connolly and de Melo 1994). Resistance to the accompanying suppression of non-favored imports was such that it was estimated that, in 1965, one quarter of all imports were illegally smuggled into the country (Shapiro 1969).

In 1972, the currency began to be devalued on a gradual but continuous basis, instead of in large, disruptive steps. In 1974, cross-border capital flows were fully liberalized, and dollar-denominated transactions, including bank deposits and loans, were authorized. In 1978, in order to influence inflation expectations, the peso began to be devalued at a pace established and announced by the authorities in advance. As concerns foreign trade, quantitative restrictions were eliminated in 1975; in 1978 domestic beef prices were deregulated; and in 1979

Uruguay signed the GATT subsidy code, which required it to end the longstanding practice of providing subsidies to uncompetitive exporters.

In the 1980s, trade was further liberalized, with peak tariff rates initially cut from 116 to 75%, then to 55, and eventually to 40%, while the lowest rates were set at 10%, though most non-tariff barriers (e.g., export taxes and bans) were maintained. Following a major economic and financial crisis in 1982, preannounced exchange rates were replaced by a dirty floating rate, which was managed to ever-greater weakness in line with actual inflation.

Trade liberalization forced the authorities to find other ways to promote investment and job creation in promising new industries, and this was accomplished in the 1980s and thereafter via laws setting up duty-free zones (targeting initially warehousing, logistics, and other services) and granting tax and other incentives to forestry and related industries (both in 1987), as well as to new hotels (Antía 2001).

Other contributors to the vicious cycle were irresponsible fiscal and monetary policies. Studies show that, starting in the late 1950s, fiscal deficits and their inflationary financing explain the origin and persistence of Uruguay's high inflation, which lasted until the early 2000s (IMF 2022, Oddone and Marandino 2021). Between 1960 and 1973, in particular, the main source of deficit financing was central bank lending to the government, since monetary policy was lax and interest rates generally lagged behind inflation—thus little demand for public debt in a context of limited access to external bank or bond financing (Oddone and Marandino 2021; Bertoni and Sanguinetti 2004).

There is evidence of a relationship between elections and inflation cycles. Inflation accelerated in the aftermath of five national elections held between the late 1950s and the late 1980s, during which there was a fiscal deterioration in both the year before and the election year itself. For example, the fiscal accounts went from balanced in 1956 to a deficit equivalent to 12% of expenditures by 1958, and inflation accelerated from 6 to 49% by 1959. Additionally, the government went from posting a surplus in 1960 to a whopping deficit of 31% of spending by 1962, and inflation likewise accelerated from 10 to 44% by 1963. Similar coincident fiscal and inflationary conduct was observed in 1970–1971, 1983–1984, and 1988–1989.[5]

These apparent election-driven fiscal cycles took place irrespective of the political party in power (Aboal et al. 2003). In Uruguay and elsewhere, studies show that when combined with poorly managed exchange rates, pervasive price controls, and restrictive trade regimes, inappropriate fiscal policies usually resulted in accelerated inflation, production bottlenecks, export slowdowns, and crippling losses of international reserves (Corbo and de Melo 1987).

The economic decay that started in the mid-1950s had serious social and political repercussions. In 1958, for the first time in nine decades, the Colorado Party lost the presidential election to its opponent, the National ("Blanco") Party, which also went on to win reelection in 1962. This historic upset was due to widespread dissatisfaction with the ongoing stagflation, including anger among rural communities at the discriminatory trade and currency restrictions—so much so that it led to the liberalizing reforms of 1959 (Finch 1981). But since neither this Blanco nor subsequent Blanco or Colorado administrations proved able to deliver better economic outcomes, Uruguay's previously strong social fabric began to unravel.

In particular, because wages were not regularly adjusted for accrued inflation, as they were in other inflation-prone countries like Brazil (Messina and Sanz-de-Galdeano 2014), Chile and Colombia, labor strikes demanding such catch-up adjustments soon became a nearly daily, hugely disruptive phenomenon. Especially from the late 1960s until the early 1980s, after years of high inflation, poor job prospects, consumer shortages, and currency debasement, people started to emigrate from Uruguay in growing numbers—a first for this traditionally immigrant country. It is estimated that during 1962–1990, a net of nearly 300,000 inhabitants left Uruguay, the equivalent of 11% of the 1960 population.[6]

Making matters worse, during the 1960s street violence (mainly riots) worsened, and even an armed insurgent group, the Tupamaros, came onto the national scene and caused mayhem mainly in Montevideo. They posed such a ferocious affront to law and order that in 1973 the armed forces, by design and default, moved into the political arena and became the power behind several civilian presidential appointees (Sondrol 1992). While they quickly defeated the Tupamaros, they stayed on until, in 1980, their attempt to legitimize their governance role lost a popular plebiscite. Once they were also confronted by a major economic crisis and growing labor discontent, the armed forces allowed for elections (in late 1984) and returned to their barracks (in March 1985), whereupon democratic rule was restored.

But causality between economics and politics in Uruguay ran both ways because institutional factors contributed to a poor investment and growth climate, as well as to needless instability in key nominal variables, such as chronic inflation and currency weakness. Among the leading factors were the weakening of governments' political authority, increased political fragmentation, excessively discretionary exchange-rate policies, and the aforementioned electoral cycles in fiscal policy (Oddone 2008). For example, it has been established that governments lacking a congressional majority tended to run larger fiscal deficits (Aboal et al. 2003), and that currency devaluations tended to run slower in election years and faster in the aftermath of elections (Aboal, Lorenzo, and Rius 2003).

1991–2023: A MOSTLY VIRTUOUS CYCLE

In the early 1990s, Uruguay entered a nearly 35-year period characterized by economic renewal, diversification, and faster growth; increasingly responsible fiscal, monetary, and exchange-rate policies; and more inclusive and environmentally sustainable government initiatives. Although there was a major economic and financial crisis in 2002, and the country was impacted by the Covid pandemic of 2020, policymakers and the population handled both emergencies well, and the economy bounced back quite rapidly.

During 1991–2023, the annual inflation rate averaged 16%, though it has run steadily under 10% since 2004—under 5% in the first half of 2024—and the yearly compounded real GDP per capita growth rate was an improved 2.2%.[7] As a result, whereas by the late 1980s Uruguay's PPP-adjusted per capita income had dropped to a level about 45% of New Zealand's, by the early 2020s it had outperformed to reach 55% of New Zealand's.[8]

The main reason why a vicious cycle turned into a virtuous one was a streak of more enlightened and courageous political leaders. Presidents Luis Alberto Lacalle (1990–1995), Julio María Sanguinetti (1995–2000), and Jorge Batlle (2000–2005), guided by better-trained economic advisors, committed themselves to creating a more attractive climate for investments and new exports through sounder macroeconomic policies, assured rights to land and intellectual property, transparent and fair rules for business, and selective subsidies and guarantees to new investors. They understood the importance of reducing fiscal deficits and financing them better (including by restructuring the foreign debt under the aegis of the Brady Plan),[9] putting a stringent limit on central bank lending to the government,[10] opening up the economy, including through a trade agreement (Mercosur) with neighboring countries, allowing for private investment in wind and other sources to minimize reliance on imported petroleum,[11] and deregulating domestic markets (Baraibar 2020).

Lacalle inherited triple-digit inflation and a monstrous 1989 fiscal deficit equivalent to 35% of revenues. His administration immediately proposed, and obtained opposition support to pass, a comprehensive revenue-raising fiscal effort to yield the equivalent of 4 percentage points of GDP (Talvi 1995), but by 1992 it had delivered an extra 7 points of GDP (Tiscordio and Bucacos 2009).

The challenge was not only to cut the budget deficit but to find ways to offset the threat of fiscal insolvency posed by a 1989 constitutional reform, which mandated pensions to be updated thrice yearly according to an index of recent wages—despite the fact that the main retirement fund was already in the red, posting annual deficits in excess of 3% of GDP (Fernández Castro 1997). It would not be until 1995 that the pension system was reformed to raise the minimum age, tighten eligibility conditions, and allow for individual retirement accounts managed by private pension funds, whose payouts would depend on contributions and performance.[12] It was supplemented by an early retirement program for surplus government employees, which also helped put the fiscal accounts on a viable track.[13]

The fiscal correction was accompanied by a new exchange-rate policy whereby the peso was devalued at an increasingly slower rate, in order to anchor expectations of decelerating inflation, but without a preannounced path. Given widespread dollarization, it was felt that the exchange rate could not be freed to reflect market forces because then a self-fulfilling, inflation-devaluation cycle would prevent any stabilization. Moreover, to supplement the policy signal, government salaries began to be adjusted in line with targeted, rather than actual, inflation (Talvi 1995).

When it came to the economy, the Lacalle and two successor administrations dismantled most industrial favoritism and encouraged a renewal and diversification of agrarian-based exports by cutting or eliminating export taxes and import tariffs on capital goods and intermediate inputs, thus enabling the livestock sector to revive and enter a period of increased output and productivity. In addition, the benefits of purely grass-fed cattle, as well as the quality and taste of the beef, were marketed abroad such that Uruguay positioned itself as a provider meriting higher prices. Additionally, in 1994 Uruguay managed to gain recognition as free of foot-and-mouth disease without vaccination, opening up access to the most demanding and rewarding beef destinations in the world (Baraibar 2020).

The authorities encouraged competitive export diversification by passing, in 1987, a law providing tax exemptions to plant new forests, with a view to eventually exporting logs and pulp, while simultaneously prohibiting the logging of native forests for conservation reasons. Soon after, major foreign companies arrived, liked what they saw, and announced and implemented multibillion-dollar investments in plantations, sawmills, and pulp mills (Baraibar 2020). The area covered grew rapidly, from fewer than 200,000 forested hectares in 1990 to 750,000 by 2006 and 1.1 million by 2021 (MGAP 2022). Forestry exports increased from less than $100 million before 2008 to $2.5 billion in 2022 (MGAP 2024).[14] They are expected to earn more than beef, the leading export category, starting in 2024.

Governments also took steps to make other investments in agriculture more attractive and to reduce production costs. In 1990, an institute was established with funding for agricultural R&D; in 1991, a law allowed for shorter-term land contracts and reduced the rights of existing long-term tenants; in 1992, a law opened up investment and management opportunities in harbors, encouraging enhanced trade capacity and lower shipping costs; and in 1999, another law let corporations own and lease land (Baraibar 2020). These initiatives enticed mainly Argentine and Brazilian investors to buy land for farming purposes, and from 2002 to 2012, annual foreign direct investment from Argentina in farmland and other ventures increased 26-fold (Che 2021). An example of great success was soybean production, spearheaded by Argentine investors: at their peak, soy exports earned $1.9 billion in 2022, up from almost zero in the early 2000s.

Another initiative was for Uruguay to join its three neighbors in 1991 to form Mercosur, which was to become a common market by 1994.[15] While the grouping has yet to fully achieve that, by reducing most barriers to regional trade, Mercosur at least provided a new outlet for Uruguay's uncompetitive industries like automotive parts and chemicals, plus some farm products, that had trouble exporting—a move rightly derided as a regional extension of the moribund import-substitution strategy (Connolly and de Melo 1994). By 1998, Mercosur became the destination of 55% of Uruguay's exports, up from 34% in 1990, but over time the country's new, competitive exports, like forestry and soybeans, surged ahead and found eager markets in China and beyond, such that since 2014 Mercosur has been the terminus of less than one quarter of the country's exports.[16]

The reduction in regional trade barriers, especially with Argentina, made sense because of the very high correlation between the two countries' business cycles since the 1940s (Voelker 2004). From the early 1980s to the late 2000s, Argentina accounted for about one-fifth of Uruguayan output fluctuations because of idiosyncratic real-economy and financial linkages between them, whereas shocks from Brazil had much less impact (Sosa 2010). However, in the most recent decade and a half, there has been a decoupling from Argentina's volatility, especially since Uruguay reoriented its export growth toward China and its banking system was strengthened significantly to withstand financial shocks coming from that troubled neighbor (Dianessi et al. 2020).

Starting in 1999, economic slowdowns and financial crises in Argentina and Brazil impacted Uruguay through its close trade and financial links. The country fell into a deep, four-year recession, and its relatively rigid exchange-rate regime could not be maintained, especially after a freeze on bank deposits in Argentina, starting in December 2001, drove Argentines to withdraw funds they had deposited in Uruguay—soon panicking Uruguayan depositors as well. The resulting banking, fiscal, and currency debacle was handled very constructively, with Uruguay earning the support of its foreign private creditors, the Washington-based multilateral institutions, and the U.S. government. The authorities implemented a decisive fiscal austerity plan that, though painful, gained broad political support and hit the mark; obtained a bridge loan from the U.S. Treasury and new, long-term loans from the multilaterals; and organized a friendly, value-preserving reprofiling of time deposits in illiquid banks and public debt falling due.[17] Last but not least, Uruguay finally adopted a freely floating exchange-rate regime and an independent monetary policy, both of which have served it very well ever since (IMF 2007; IMF 2023; Steneri 2011).

In 2004, and for the first time ever, a leftist political coalition (the Frente Amplio) won national elections with comfortable majorities in the legislature. But rather than undoing any of the sensible, market-friendly reforms of the 1990s, the administrations of President Tabaré Vázquez (2005–2010) and the two that followed (José Mujica 2010–2015 and a reelected Tabaré Vázquez 2015–2020) complemented them. Early on, they prioritized inclusivity by establishing social assistance programs (mainly food and family allowances) to benefit the lowest quintile of the income distribution; undertook a major reform of the healthcare system to widen access to it; and established an agency to fund research and development mostly by the private sector, complementing the existing agricultural R&D entity (ANII 2024, INIA 2024).

At the same time, importantly, in 2007 the government enacted a tax reform that raised the needed revenues, featuring progressive taxes on personal income (10–30%) and on capital gains (3–12%) such that fiscal deficits remained low (IMF 2015). Recent studies show that Uruguay not only stands out in regional comparisons as one of the most egalitarian but also the most redistributive country, because as of late most taxes and transfers meaningfully reduce inequality and poverty (Bucheli, Lara, and Tuzman 2020).[18]

In 2020, shortly after a new Blanco president (Luis Lacalle Pou, 2000–2025) took the helm, the Uruguayan economy was severely affected by the Covid pandemic, but it rebounded within a year (MEF 2024). The fiscal deficit increased by two percentage points of GDP, yet by 2021, it was back down close to its pre-pandemic level (MEF 2024). Good management by the government and good compliance by the population combined to produce better pandemic results than the average for six major Latin American countries and even the United States (Bucacos et al. 2023; IMF 2023). The authorities also took initiatives to improve the quality of public education; promote public-private partnerships in logistics and infrastructure; enact a fiscal rule to keep government spending in line with potential economic growth; and strengthen the pension system by raising the retirement age from 60 to 65 years.

AN AGENDA FOR THE FUTURE

The distinctive element driving economic development in recent decades has been investment in human capital, including adaptive learning skills in individuals and advancements in governance in businesses and the public sector. Therefore, sustainable economic growth and development require steady improvements in education and skills, as well as in the quality of institutions (Rodrik and Stiglitz 2024). To speed up the rise of living standards, the following are the principal challenges facing the Uruguayan economy from a medium- and long-term perspective.

The public educational system must be modernized further. Although a century ago, indicators of human capital development showed Uruguay at a considerable advantage relative to its Latin American peers and even those of the Iberian Peninsula and Italy (Bértola et al. 2012), the country has lost relative ground in recent decades. Increasing pedagogical time in quality-based educational centers (UNICEF 2020), institutional and cultural changes in educational leadership, adopting strategies that allow a leap in secondary education to develop cognitive, digital, and socio-emotional skills, especially with clearer links to the labor market (CEPAL 2022), and broader access to tertiary education (Labraña and Brunner 2022), are the principal means to achieve better educational outcomes.

Increased investment in science, technology, and research is another priority. Uruguay has put in place a national innovation system to reduce coordination failures among actors and mismatches between policies, but the advisory agency at its core (CONICYT) is not empowered to resolve such problems—thus they linger because of government inaction. Tax breaks to encourage private-sector R&D should be considered, and intellectual property regulations ought to be improved because they do not sufficiently incentivize patent holders and are not in line with commitments made in international treaties (Codner 2022). Given that product and marketing innovations tend to be spurred by the opening up of new foreign markets, it would behoove Uruguay to enter into more trade agreements with countries outside Mercosur (Horta, Silveira, and Ferreira 2021).

The development process requires structural transformations that consider aspects such as environmental sustainability, climate change, social inclusion, and good governance. Uruguay has made good progress in these areas, but more can be done. The country has begun to position itself as a provider of certain global services, such as information and communication technologies and business processes (CED 2023). The biopharmaceutical industry holds significant potential if it could better exploit local know-how and production capacity, including in animal and human vaccines and clinical research in human health (Bianchi 2021). Uruguay has attracted the international film industry and other cultural and creative endeavors, given natural, architectural, and demographic features and tax advantages (Uruguay XXI 2022). And there are still unexploited opportunities for the attraction of more tourists beyond the usual ones coming mainly from Argentina (CERES 2022).

Overcoming its demographic challenge would help raise the country's economic potential. The most glaring problem is the aging of the Uruguayan population, which has adversely affected the pension, educational, and healthcare systems, as well as the labor market (Rofman, Amarante, and Apella 2016). In recent years, however, there has been an influx of both highly qualified and poorly educated immigrants to Uruguay, and they are starting to make a difference for the better (Koolhaas and Pellegrino 2020). Working on incentives for this migrant flow to continue in a significant but orderly manner has great potential, given the emigration wave of prior decades and the ultra-low reproductive rates of the native population (CED 2023).

The modernization of government services is another pending matter. The goal should be to enhance the quality and efficiency of its activities, shifting the focus from the logic of proceedings to that of people-oriented services, taking advantage of new technological tools (CED 2023). There is also a need to redefine the functions of some ministries, for the sake of better organizational coordination and the elimination of overlapping responsibilities. Similarly, the role of existing state-owned enterprises should be adjusted, given a changing world where natural monopolies and competitive conditions have been modified by technological transformations and global geopolitics (CCE 2018; Munyo and Regent 2015).

The labor market could use more flexible regulations and practices. Automation processes, artificial intelligence, and online work have changed the terms of workplace engagement such that the relationship between productive factors is more depersonalized, diversified, and internationalized. The rise of Uruguay as a provider of global business services and the arrival of entrepreneurial immigrants have opened up a completely new horizon (Mazzuchi 2023). And yet, Uruguay is burdened by an antiquated, centralized system of labor relations, which means that adjustments to salaries, ranks, and other working conditions are negotiated industry by industry and apply to all firms, regardless of worker productivity and enterprise profitability. Flexibilization and modernization are warranted to give businesses more degrees of freedom to allow for differences in firm size, location, orientation, labor productivity, and profitability (Apella and Zunino 2022).

The small size of Uruguay's economy mandates that foreign trade should be as liberalized as possible, yet membership in Mercosur has become a constraint on the country's ability to negotiate one-on-one trade agreements (e.g., with China) or to join the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership), still open to other countries. While the export of services is not constrained by Mercosur rules, when it comes to products, they do discourage Uruguay's integration with existing or new global value chains (Lalanne 2021).

The maintenance of Uruguay as a relatively safe, non-violent destination for tourists and foreign investors—never mind for the local population—needs to be buttressed because of the spread of drug-related crime throughout Latin America. Uruguay is not immune to a regional trend of rising urban violence, kidnappings, vigilantism, and environmental conflicts, although it started out from low levels, and an uptick in homicides has had repercussions on public opinion (Baudean and Rudnitzky 2023). Laws and social policies should be updated to account for the new types of crimes and criminals involved, addressing homicides committed by criminal gangs through improved investigations and targeted deterrence. In addition, measures should be taken to minimize crimes against property and of a sexual nature through more extensive reliance on technology as well as social and health services (Rojido, Cano, and Borges 2023).

And last but not least, care must be taken to preserve the gains that have been made in terms of improved macroeconomic and macrofinancial practices and institutions (Le Fort, Gallardo, and Bustamante 2020)—of the kind that have been recognized internationally by awarding Uruguay a coveted investment-grade rating.[19] Policies capable of moderating business cycles and reducing external vulnerabilities allow for a more competitive economy—one that attracts local and foreign investment and one in which jobs, incomes, and living conditions have a better chance to improve (Sarmiento 2020; Lanzilotta, Zunino, and Mosteiro 2023). Despite the recent reduction in annual inflation to low single digits, in a context of greater fiscal responsibility and sustainability (CFA 2023), measures are yet to be taken to lower the relatively high cost of doing business in Uruguay (Eilender et al. 2024; CPA-Ferrere 2024), a condition that impacts its competitiveness, especially as of late because the country's currency has been either stable or strong.

CONCLUSIONS

Uruguay remains one of the most prosperous countries in Latin America, with a 2023 per capita GDP of $21,600 in current dollars, the highest in South America, and a per capita GDP of $28,500 in purchasing-power-adjusted current dollars, the second-highest after Chile ($30,000). However, its economic growth trajectory has been modest and accident-prone, preventing Uruguay from converging through time to the PPP GDP per capita levels of high-income countries such as New Zealand ($53,000)—never mind the United States ($82,000).[20]

During the five decades from the 1930s to the 1980s, governments undermined the country's comparative advantage in livestock production through discriminatory trade, tax and exchange-rate policies, while favoring new but mostly uncompetitive industries and farm crops by similar means. Uruguay's capacity to earn dollars through exports was reduced, and so was its ability to afford imports and sustain economic growth.

Those circumstances warranted restrictive fiscal and monetary policies, market-driven exchange rates, and a reversal of misguided resource-allocation policies, but from the 1950s through the 1980s, successive governments did not deliver them. The unfortunate results were accelerating inflation, chronic currency devaluation, economic stagnation, crippling banking, currency and debt crises, as well as social and political turmoil.

Since the early 1990s, however, a new crop of enlightened political leaders from center-right and leftist parties has implemented increasingly appropriate macroeconomic policies and bold structural reforms. These have fostered macrofinancial as well as social and political stability; environmental sustainability, especially in energy production; the attraction of foreign direct and portfolio investment; and the development of new comparative advantages in agriculture and services, such that dollars have no longer been scarce, as evidenced by the stability and even appreciation of the Uruguayan peso.[21]

Yet Uruguay's tale of economic successes and failures makes one wonder how much better outcomes would have been obtained if this country, one of the smallest and least populated in South America, endowed with one of its best harbors, had long ago chosen the path of unilateral free trade—like Hong Kong and Singapore did—and had maintained through time the political support necessary for sounder macroeconomic policies.

NOTES

1. Authors' calculations based on goods exports excluding duty-free zones.
2. During this cycle, there were banking crises in 1965, 1971, and 1982 (Pérez-Campanero and Leone 1991, and Vaz 1999), and government defaults on foreign-currency debt in 1983, 1987, and 1990 (Duggar 2013).
3. Authors' calculations for inflation based on INE 2024a; real GDP on Bértola, Román, and Willebald 2024; and population on Bértola, Camou, and Lara 2024.
4. PPP = purchasing power parity, 2011 prices; authors' calculations based on Maddison Project Database 2020, 2024.
5. There was no such fiscal swing in 1965–1966. Authors' calculations based on IMF 2024a, IMF 2024b, and INE 2024a.
6. It is estimated that, as of 2000, about half of Uruguayan emigrants were living in Argentina and one-tenth each in Brazil, Spain, and the United States (Cabella and Pellegrino 2005). Net outmigration of nearly 540,000 during 1962–2021 was the equivalent of 21% of the 1960 population. Authors' calculations based on World Bank 2024a and 2024b.
7. Authors' calculations for inflation based on INE 2024a; real GDP is based on Bértola, Román, and Willebald 2024 (1990–2018) and Banco Central del Uruguay 2024 (2019–2023); and population data is based on Bértola, Camou, and Lara 2024.
8. PPP = purchasing power parity, 2011 prices. Authors' calculations based on the Maddison Project Database 2020, 2024, updated with PPP data at 2017 prices from IMF 2024c.
9. The Brady Plan, embraced by Uruguay in 1991, allowed for discounted amounts and lower interest rates, as well as longer maturity profiles, on $1.6 billion in debts to foreign commercial banks while accessing new loans mainly from multilateral agencies.
10. In 1995, the legislature passed a new central bank charter that set a limit (Art. 47–48) on how much it can lend to the government (Parlamento del Uruguay 2024).
11. In 2005, the government set out to radically change its energy matrix from fossil fuels to renewable sources, mainly by having private companies set up and maintain wind turbines that would power Uruguay's grid under contract from the public utility that distributes energy, such that by 2018–2022, more than 90% of total electricity generation was derived from renewable sources (SEC 2023).
12. This reform, which the Lacalle administration was unable to pass but that the successor Sanguinetti government did, implied avoiding a trajectory that would have led to annual

operating deficits as large as 10% of GDP, keeping them at around 2% of GDP (Fernández Castro 1997).

13. The number of civil servants and workers in state-owned enterprises had grown from around 10% of the nation's workforce in the mid-1940s to a peak of 23% by the late 1980s. Authors' calculations based on FCEA/Udelar 2024a and 2024b.
14. Exports from the duty-free zone were included.
15. Internal tariff rates among Mercosur countries were reduced to zero as of 2000 except for sugar and autos, but the common external tariff still has hundreds of exceptions, especially for capital goods' imports from outside Mercosur (SEC 2023).
16. Authors' calculations based on IMF 2024d.
17. The negotiated restructuring of the government's universe of foreign-currency securities with a maturity greater than 12 months involved solely a 5-year maturity extension; immediate estimated losses, measured by trading prices, were on the order of 34% (Duggar 2013). Uruguay was able to return to the voluntary international bond market within several months, and within two years, bond trading prices had fully recovered (Steneri 2011).
18. Uruguay's Gini coefficient decreased from levels close to 0.35 in the 1930s to 0.30 in the mid-1960s, but it increased notably during the dictatorship (1973–1985) and afterwards through the beginning of the 21st century, stabilizing at 0.46 (Bértola 2005; Alves et al. 2012). It dropped again after 2009 to an annual average of 0.40 during 2011–2022, mainly because of the redistributive policies put in place by the Frente Amplio administrations (World Bank 2024c).
19. Chile, Peru, and Uruguay are the only countries in South America to have received such an investment grade from the leading credit-rating agencies (Trading Economics 2024).
20. Authors' calculations based on IMF 2024c.
21. For the first time in many decades, the Uruguayan peso actually appreciated versus the U.S. dollar during March 2020–July 2024. Authors' calculations based on INE 2024b.

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