Inter-American Development Bank

Board of Executive Directors

For consideration

On or after: 10 August 2005

PR-2957
19 July 2005
Original: Spanish

To:	The Board of Executive Directors
From:	The Secretary
Subject:	Uruguay. Proposal for a loan for a social sector program

Basic Information:	Borrower	…………………………………… Eastern Republic of Uruguay
	Amount	………………………………...……… up to US$250 million
	Source	……………….... Single Currency Facility of the Ordinary Capital

Inquiries to: Mr. Jesús Duarte (extensión 2809)

References: GN-1838-1(7/94), DR-398-5(5/03)

Other distribution: Representative in Uruguay

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

URUGUAY

SOCIAL SECTOR PROGRAM

(UR-L1003)

LOAN PROPOSAL

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Basic socioeconomic data	http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata
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ABBREVIATIONS

ANEP	Administración Nacional de Enseñanza Pública [National Public Education Administration]
BPS	Banco de Previsión Social [Social Security Bank]
CESI	Committee on Environment and Social Impact
CIP	Comité Interinstitucional del Programa [Program Interinstitutional Committee]
ECH	Encuesta Continua de Hogares [Ongoing Household Survey]
EHA	Encuesta de Hogares Ampliada [Extended Household Survey]
EIGH	Encuesta de Ingresos y Gastos de Hogares [Household Income and Spending Survey]
FIEL	Latin American Economic Research Foundation
GDP	Gross domestic product
ICC	Índice de Carencias Críticas [Critical Deficiencies Index]
IMF	International Monetary Fund
INE	Instituto Nacional de Estadística [National Institute of Statistics]
MEF	Ministry of Economy and Finance
MIDES	Ministry of Social Development
OPP	Oficina de Planeamiento y Presupuesto [Planning and Budget Office]
PANES	Plan de Atención Nacional a la Emergencia Social [National Social Emergency Plan]
PBL	Policy-based loan
PCU	Program Coordinating Unit
PSS	Public social spending
RUB	Registro Unificado de Beneficiarios [Single Record of Beneficiaries]
SAF	Sistema de Asignaciones Familiares [Family Allowance System]
SAF-HMR	Sistema de Asignaciones Familiares - Hogares de Menores Recursos [Family Allowance System – Low-income Households]
SBA	Stand-by arrangement
SMEs	Small and medium-sized enterprises
SPDPL	Social Program Development Policy Loan
UNDP	United Nations Development Programme
WB	World Bank

PROJECT SUMMARY
URUGUAY
SOCIAL SECTOR PROGRAM
(UR-L1003)

Financial Terms and Conditions [1]				
Borrower: Eastern Republic of Uruguay Executing agency: Ministry of Economy and Finance (MEF)			Amortization period:	20 years
			Grace period:	5 years
			Disbursement period:	Maximum 24 months
Source	**Amount (US$ million)**	**%**	Interest rate:	Variable
IDB (OC)	250	100	Inspection and supervision fee:	0%
Local	0			
Other cofinancing	0		Credit fee:	0.25%
Total	250	100	Currency:	United States dollars

Project at a glance

Program objective:

The objective of this program is to support the new government in developing and implementing a social policy to reduce poverty, improve the human resource base among the poorest of the population, and strengthen the social sector's institutional framework with a view to making social policy more effective. The resources freed up by the disbursements will enable Uruguay to fulfill its financial obligations under its agreements with international organizations.

The proposed program consists of policy actions to alleviate poverty among those most affected by the crisis, and to reform the institutional framework of the social sector. The sector loan is for the amount of US$250 million, and is to be released in two equal tranches.

The program calls for: (i) stable macroeconomic conditions; (ii) a strategy of immediate and comprehensive actions targeting the population living in extreme poverty and exclusion; and (iii) the creation of a new institutional framework for coordinating, monitoring, and evaluating social policy. The specific conditions for each of the operation's tranche releases are set out in paragraphs 3.8 and 3.9, and in the program's policy matrix.

Project consistent with country strategy: Yes [x] No [ ]

Project qualifies as: SEQ[x] PTI [ ] Sector [ ] Geographic [ ] Headcount [ ]

Verified by CESI on: 17 June 2005

1 The interest rate, credit fee, and inspection and supervision fee mentioned in this document are established pursuant to document FN-568-3-Rev. and may be changed by the Board of Executive Directors, taking into account the available background information, as well as the respective Finance Department recommendations. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed 1% of the loan amount. (*)

(*) With regard to the inspection and supervision fee, in no case will the charge exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

I. FRAME OF REFERENCE

A. Macroeconomic framework

1. Crisis and recovery

1.1 Between 1999 and 2002, Uruguay experienced a prolonged recession that culminated in the economic and financial crisis of 2002. This situation was caused by a series of external and internal shocks brought on by the devaluation of the Brazilian real in 1999, a deterioration in the terms of trade (export prices fell 17% and oil prices rose between 1999 and 2001), an extended drought in 1999, and the resurgence of foot-and-mouth disease in 2001. In addition, Uruguay was impacted by the collapse of the Argentine economy in the second half of 2001, which unleashed a run on deposits and caused a deep financial crisis that resulted in an 11% decline in the gross domestic product (GDP) in 2002.

1.2 In this context, unemployment reached a historic high of 19.8% in September 2002, while the steady decline in tax revenues caused a fiscal deficit that surpassed 4% of GDP in the 1999-2002 period. By late 2002, the combination of financial assistance to banks, the need to finance the fiscal deficit, and the sharp fall in the GDP raised the public debt to 94.2% of the GDP.

1.3 The Government of Uruguay responded to this situation with vigor. In March 2002, it signed a stand-by arrangement (SBA) with the International Monetary Fund (IMF), and a financial assistance package with multilateral agencies that made it possible to implement a strategy to overcome the crisis. The most important elements of this strategy were: (i) a solution to the banking crisis that fully upheld contracts, maintained original currencies, and avoided overall restrictions; (ii) a voluntary debt exchange, which made it possible to reorganize public accounts and relieve the burden of amortizations for the rest of the decade; and (iii) the meticulous management of monetary policy and fiscal austerity.

1.4 This strategy revived confidence in the financial system, contained capital flight, strengthened the country's fiscal and external position, and made debt sustainability possible. By 2004, the economy had grown by 12.3%, bringing real GDP to just 6% below the pre-recession level. Prudent management of monetary policy brought inflation down, and the peso began to appreciate. In the fiscal area, the primary balance moved from a 1.2% deficit of GDP in 2001 to a 3.8% surplus in 2004.

1.5 Despite these achievements, short- and medium-term challenges persist in a difficult social situation that is bringing pressure to bear on public spending. First, the public debt is still very high, around 92% of GDP by the end of 2004, and is denominated in dollars. This makes it necessary to continue fiscal discipline for the long run in order to reduce the debt and protect the economy from exchange rate shocks. Second, in the next three years Uruguay will have to begin making substantial amortization payments to the IMF, the World Bank (WB), and the IDB.

To a large degree, these will have to be covered with new disbursements from the programs of those institutions. Third, some structural reforms are still pending, including tax reform and banking restructuring.

2. Basic medium-term macroeconomic scenario

1.6 In order to consolidate the country's economic growth, and macroeconomic and financial stability, the new government that took office on 1 March 2005 has negotiated a new three-year stand-by arrangement (SBA) with the IMF to cover the 2005-2008 period, which was approved by the IMF Executive Board on 8 June 2005. The basic assumptions of the medium-term macroeconomic scenario negotiated by Uruguayan authorities with the IMF are shown in Table I.1 below.

Table I-1
Medium-term macroeconomic framework
IMF

	Prel.	Projections					
	2004	2005	2006	2007	2008	2009	2010
		I. Production and inflation (%)					
Real annual growth GDP	12.3	6.0	4.0	3.5	3.0	3.0	3.0
Gross domestic investment (% GDP)	13.7	15.3	19.1	17.0	17.6	17.9	18
Inflation (end period)	7.6	6.5	5.5	4.5	3.5	3.5	3.5
GDP (US$ billion)	13.2	16.4	18	19.4	20.5	21.8	23.1
		II. Public sector and debt (% of GDP)					
Primary surplus	3.8	3.5	3.7	4.0	4.0	4.0	4.0
Interest	6.0	5.2	5.0	4.8	4.8	4.8	4.7
Global deficit	-2.2	-1.7	-1.3	-0.8	-0.8	-0.8	-0.7
Public debt[1]	92	76	70	66	62	59	56
		III. External sector (% of GDP)					
Exports of FOB goods (US$ million)	3.025	3.276	3.463	3.862	4.248	4.525	4.889
Imports of FOB goods (US$ million)	2.990	3.713	4.429	4.144	4.430	4.734	5.054
Current account (US$ million)	-105	-461	-958	-228	-140	-180	-140
Current account (% GDP)	-0.8	-2.8	-5.3	-1.2	-0.7	-0.8	-0.6
Balance of payments (US$ million)	425	144	210	201	163	109	166
Appreciation- real effective exchange rate (average %)	-0.2	9.4	4.1	2.5	1.0	1.0	1.0
Sovereign spread	600	450	450	450	450	450	450
Foreign debt	87.4	70.2	63.4	58.1	54.5	50.9	47.4

1 Non-financial public sector + Central Bank of Uruguay (excluding monetary policy instruments)

2 Excludes deposits by nonresidents.

Source: IMF

1.7 The basic macroeconomic scenario outlined in the agreement with the IMF includes the generation of a growing primary surplus of 3.5% of GDP in 2005, 3.7% in 2006, and 4% as of 2007. It also assumes that economic growth will hold at a rate higher than the country's historical average (around 1.7% annually), as a result of efforts to continue the structural reform process with the support of multilateral agencies. Theoretically, this will make it possible to boost investment levels and economic productivity, and gradually reduce the debt burden from 93% of GDP in 2004 to 56% of GDP in 2010.

3. Public debt sustainability

1.8 Implementation of the macroeconomic strategy designed by Uruguayan economic authorities, combined with the support of multilateral agencies, should make it possible to manage the country's enormous public debt over the coming years and place it on a sustainable course. This conclusion is based on IMF projections that take into account the supporting studies for the new SBA with Uruguay (see Table I-2). A study conducted by the Latin American Economic Research Foundation (FIEL) in August 2004 with IDB funding, and the World Bank's debt sustainability assessment for its Country Assistance Strategy (CAS) for the next 5-year period, also support this conclusion.[1]

Table I-2
IMF's debt sustainability framework

	Prel. 2004	**Projections 2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Assumptions							
1. Real growth GDP (%)	12.3	6.5	4.0	3.5	3.0	3.0	3.0
2. Apprec. effective real exchange rate (% average)	-0.2	9.4	4.1	2.5	1.0	1.0	1.0
3. Primary surplus (% GDP)	3.8	3.5	3.7	4.0	4.0	4.0	4.0
4. Sovereign spread	600	450	450	450	450	450	450
5. International interest rate (%)	5.1	5.6	5.9	5.9	6.3	6.8	7.2
Debt/ GDP dynamics	92	75.8	70.1	65.5	62.4	59.3	56.1

Source: IMF: Debt Sustainability Assessment May 2005-06-07

1.9 Maintaining a primary surplus at around 3.5% to 4% of GDP ensures that public debt will reach more sustainable levels (although still very high) by around the year 2010, provided that relatively plausible projections of economic growth materialize

[1] See World Bank: CAS May 2005-06-07 and FIEL: "Sustentabilidad Fiscal y de la Deuda Pública en Uruguay," August 2004.

during coming years (as pending structural reform programs are completed), the real exchange rate appreciates toward a long-term equilibrium value (so long as the terms of trade do not deteriorate sharply and the dollar does not appreciate significantly vis-à-vis other strong currencies), and international interest rates evolve normally. Although the risk exists that the assumptions used for projecting debt sustainability will not occur, so long as Uruguayan authorities persevere in maintaining a primary surplus on the order of 4% of GDP and manage to carry out their structural reform programs to spur economic growth in the medium and long terms, it is plausible that the high level of public debt can be managed in a sustainable manner.

4. Financing needs

1.10 The financial support of multilateral agencies is crucial to the success of the government's macroeconomic strategy. The strategy designed by Uruguayan authorities manage the debt over the next five-year period is based on fulfilling the new agreement with the IMF, which will ensure a flow of financing from multilateral agencies that will enable the government to repay its loans during the period, and have unobstructed access to international capital markets for new financing to deal with the remaining fiscal deficit and for reducing its debt with the IMF.

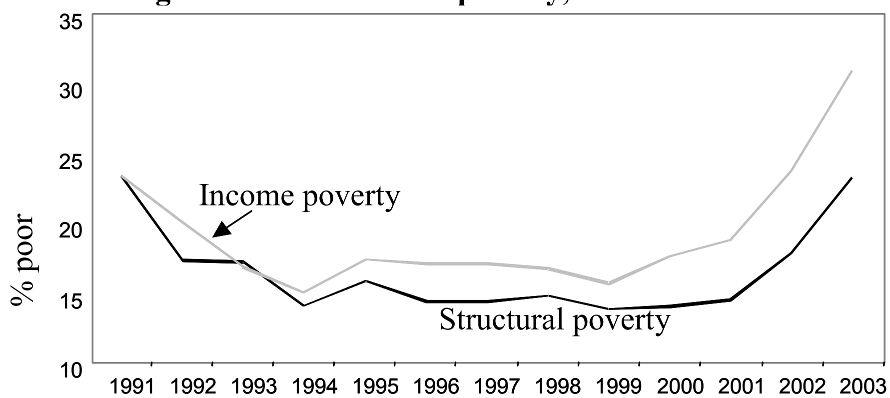
1.11 Uruguay will need an estimated US$843 million in 2005, US$1.141 billion in 2006, and US$1.314 billion in 2007, to cover the loans that come due with multilateral agencies. To cover these payments, Uruguay can place the new debt on international financial markets, the value of which authorities have estimated at an average US$500 million per year, and use the proceeds of new loans from international lending agencies. Thus, financial assistance from the IMF, the World Bank, and the IDB (of which this US$250 million loan operation for the social sector is a key component), combined with uninterrupted access to international capital markets, should ensure the sustainability of Uruguayan public debt in the coming years.

B. Poverty and equity: trends and prospects

1.12 Traditionally, Uruguay has been among the Latin American countries with the lowest incidence of poverty and the lowest levels of inequality. In terms of its evolution over the past two decades, poverty declined steadily (15%) with the advent of democracy in 1985, until 1994 when the trend reversed. In 1995, the percentage of poor households began to rise, a trend that was hastened by the economic recession of 1999, and skyrocketed in 2002 (23.6%) with the onset of the financial crisis. The impact of the crisis on the economic system was expressed in

soaring unemployment and plummeting household incomes. By 2003, 30.9% of the population was poor, and by 2004 this figure had surpassed 32%.[2]

Figure 1.1. Evolution of poverty, INE 2002



Source: Rubio, M. "Pobreza, Red de Protección Social y Situación de la Infancia en Uruguay" [Poverty, Social Safety Net, and the Situation of Children in Uruguay], 2005.

1.13 Apart from growing in recent years, poverty has also worsened both in intensity and severity in Uruguay. This means that overall, poor households fell further below the poverty line. Moreover, younger age groups are also becoming more impoverished (in 2003 some 49% of the children under 18 belonged to poor households), and the geographical concentration of low-income groups is leading to increasing levels of residential segregation.

1.14 Like poverty, inequality in Uruguay worsened as of the mid-1990s, with an almost three-point increase in the Gini coefficient, from 41.6 in 1994 to 44.5 in 2003. This change played an important role in increasing poverty during the economic crisis. A breakdown of the change in the incidence of income poverty shows that, while the decline in average incomes was the most significant factor in terms of increased poverty before and during the economic crisis, greater inequality explains almost 40% of the change that occurred during the crisis, as compared to 24% before the crisis.

1.15 Signs of increased structural or long-term poverty emerge in this setting of growing poverty and inequality. In the absence of panel data that would make it possible to identify households characterized by structural poverty, an IDB-financed study

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2 The data on poverty referred to in this document are based on the poverty line modified by the National Institute of Statistics of Uruguay (INE) in 2002.

examined poverty attributed to the inability to generate income during the 1991-2003 period.[3] The study's findings show that structural poverty grew steadily during the 1990s, although at a more stable rate than income poverty. However, both indicators increased dramatically with the crisis of 2002, showing that the crisis deteriorated both current income and the capacity of households to generate resources. Sixty percent of poor households (around 120,000 families) are characterized by structural poverty.

1.16 Although Uruguay's economy showed signs of recovery in the 2003-2005 period, this is still not reflected in the well-being of households. Despite the growth in economic activity in 2003 (7% and 16% for the last two quarters of the year, respectively, as compared to the same period the previous year), and the more than three percentage point decline in unemployment, poverty rose more than 7 percentage points as compared to 2002. The figures available for 2004 and 2005 show a continuation of this trend: even with a 12% growth in GDP and another almost three percentage point decline in the unemployment rate in 2004, there was an increase in the incidence of poverty (from 30.9% in 2003 to 32.1% in 2004) and extreme poverty (from 2.8% in 2003 to 4.0% in 2004).

1.17 In conclusion, Uruguay is emerging from the crisis with a need to adjust its social programs and institutions so that it can tackle the new situations that were developing and then worsened in the recent past. First, the high levels of poverty and its increasingly structural nature require that programs be developed that combine poverty relief with efforts to strengthen the human resource base. Second, greater inequality suggests that social investment should focus on the most vulnerable groups, especially in a context of limited financing. Lastly, because economic recovery has not produced a significant recovery of income levels, it is necessary to address emergency situations that have persisted since the crisis.

C. Public social spending and its scope

1.18 Poverty is growing in a context of high public social spending (PSS). Although PSS in Uruguay is one of the highest in Latin America, it is rigid and procyclical in that 60% of it corresponds to retirement and pension payments, and the rest to social security spending that benefits only 43% of the total population. Moreover, the PSS is heavily biased toward universal programs, with 89% going to social security, education, and health, while social welfare, which includes poverty alleviation programs, only receives 11%.[4]

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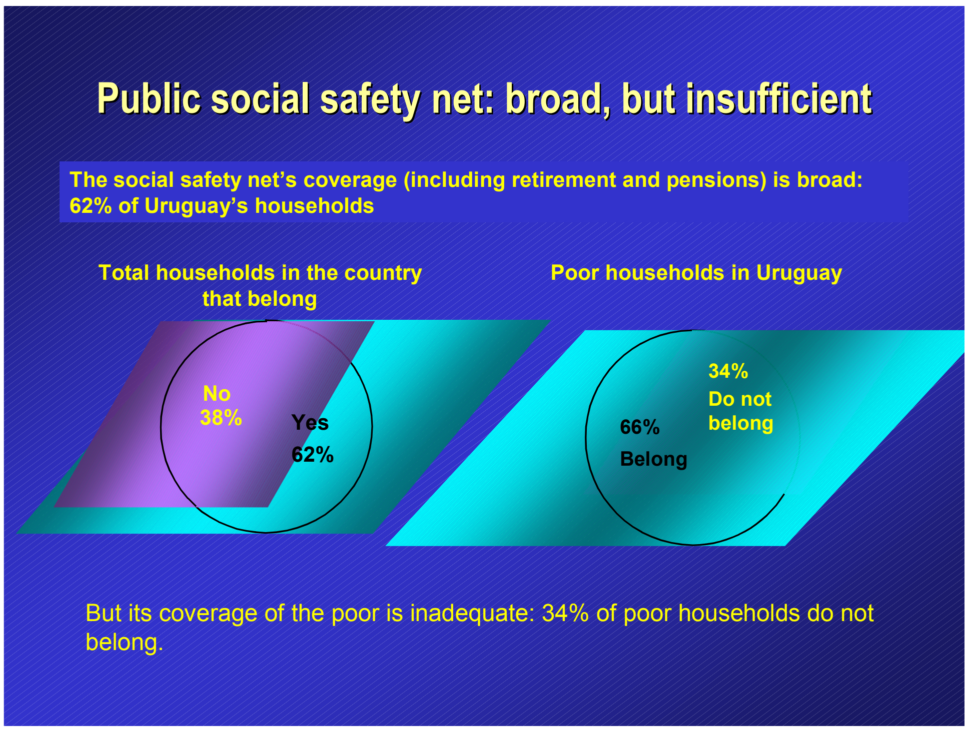
3 See Rubio (Coord.) et al. (2005), "Pobreza, red de protección social y situación de la infancia en Uruguay" [Poverty, Social Safety Net, and the Situation of Children in Uruguay], IDB.

4 Flood, C. (Coord.) et al. (2005). "Análisis del Gasto Público Social" [Public Social Spending Analysis], IDB.

1.19 With this level of PSS, the social programs comprising the country's social policy, understood in the broad sense (retirement and pensions, family allowances, and unemployment compensation), reach almost two-thirds of the country's households.[5] However, despite this breadth of coverage, the programs are not well focused as they bypass more than one-third of poor households. Coverage problems are even more evident when retirement and pensions are excluded: then, more than half of poor households and 43% of households with children are not covered.

Figure 1.2



1.20 In short, although social needs in Uruguay are high, the combination of a constricted macroeconomic environment and a high PSS show that it is necessary to improve coverage of the poor without producing an untenable impact on public finance. One is faced with a paradoxical situation where a broad range of social programs that should target the poorest households leave many of these households unprotected.

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[5] WB, Socioeconomic Characterization Survey 2002.

D. Institutions, social policies, and social protection

1.21 The new government's social policy is based on the premise that structural factors (composition of programming and the institutional framework for social policy), and short-term factors (response to the 2002 crisis), help explain the existence of a broad social policy that provides incomplete coverage of poor households.

1.22 Uruguayan social policy comprises more than 80 social programs, including universal programs, longstanding single-sector programs, and smaller, more modern programs that combine targeting with a multisector approach. However, for a variety of reasons, these programs have not responded adequately to the changing conditions of poverty and inequality described in Section B. Universal programs are difficult to adapt because they are based on a service tradition that seeks to guarantee equal benefits, regardless of the situation of the individual. They are supported by powerful coalitions and are characterized by considerable budget inertia. Targeted and multisector programs require sophisticated management mechanisms and ongoing coordination, and are supported by weaker coalitions, which results in lower and fluctuating budget allocations.

1.23 This large number of programs is designed and administered by a variety of government institutions. The organizational chart of the Uruguayan government has ten institutions of different levels that are involved in social policy. Among those under the Office of President are: the Oficina de Planeamiento y Presupuesto [Office of Planning and Budget] (OPP) through the Office of the Advisor for Social Policy and externally-financed programs, four of the government's 11 ministries (education, public health, housing and land management, and labor and social security), four of 13 existing autonomous agencies (the Administración Nacional de Enseñanza Pública [National Public Teaching Administration] (ANEP), the Banco de Previsión Social [Social Security Bank] (BPS), the Consejo Directivo Central [Central Steering Council] (CODICEN), and the University of the Republic], and one of four decentralized agencies (the Instituto Nacional del Menor [National Children's Institute] (INAME)]. Half of these institutions belong to the executive branch and the other half are decentralized, autonomous agencies that are more difficult to harmonize with the former, because of their design.

1.24 In contrast to other countries that experienced similar situations, Uruguay did not set up emergency programs in direct response to the 2002-2003 crisis. Its strategy was to expand or maintain existing programs and avoid creating temporary employment or conditional grants programs that would be difficult to dismantle after the crisis. Although some aspects of this response on target, such as not interrupting the payment of salaries and pensions, prioritizing nutrition, and extending, albeit late, the Sistema de Asignaciones Familiares [Family Allowance

System] (SAF) to poor households in the informal sector,[6] no mechanisms existed for coordinating the different actions that had to be taken to tackle the situational problems created by the emergency, nor were the needs of the most vulnerable families served in coordinated fashion.

1.25 In addition, existing demographic and social information is outdated or incomplete, and does not reflect the complexity of recent history. The last Encuesta de Ingresos y Gastos de Hogares [Household Income and Spending Survey] (EIGH) was conducted in 1994-95 and does not show how consumption habits and the income structure of the population changed during the last decade. The most recent census was conducted in 1996 and the Encuesta de Hogares Ampliada [Ongoing Household Survey] (ECH) does not include towns with less than 5,000 inhabitants or rural areas. The absence of up-to-date information hinders the design of suitable policies, and the monitoring and evaluation of social sector agencies' actions.

1.26 Redefinition of social policy presents several challenges for the new government. First, given public finance limitations, it must evaluate, adjust, and expand the social programs that are in the best position to serve the poor. Second, it must coordinate the actions of government agencies involved in social policy and improve existing information in order to make actions more effective. Finally, in response to the ongoing social emergency, it must formulate a comprehensive and integrated strategy for reaching the most vulnerable groups.

E. Program strategy

1.27 The aim of the government's social policy is to guarantee that the basic needs of the entire population are met, and that conditions exist that allow for the full development of all people. It places emphasis on social justice, improved quality of life, dignified work, equity and inclusion, equitable distribution, comprehensiveness, participation, and decentralization. Its priority is to provide immediate attention to the most vulnerable sectors to reduce the risk of extreme impoverishment, and to create conditions and opportunities that provide people so affected with exit routes from poverty and extreme poverty.

1.28 In the discussions between the Bank and Uruguay to plan this year's operations, it was agreed to use the policy-based loan (PBL) as the instrument for supporting social sector reforms. The advantage of this instrument is that it provides rapid response to the need for fresh funds as part of the support package of the international financing institutions, for this and coming years. It also responds to the new government's request for support in implementing: (i) the main institutional reforms of its social program; and (ii) the policy actions designed to focus a

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[6] The SAF program has been administered by the BPS since 1980. It provides allowances to families whose incomes fall below the threshold established by law, and are pegged to the number of children in the family. Paragraph 1.30 and footnote 8 provide additional information on the expansion of the program.

coordinated package of social interventions on the poorest households of the population in the aftermath of the recent crisis.[7]

1.29 Accordingly, the program will support the government's social policy, especially its objectives to strengthen the institutional framework of the social sector and to provide immediate relief to those living in extreme poverty. One of its aims is to involve this segment in the development of the social process over the medium term, and to help correct one of the most striking features of Uruguayan social policy: the fact that its programs provide broad coverage but bypass many of the neediest people.

1.30 Program content was distilled from extensive discussions held with the government team before it took office, and benefited from sector analyses conducted by the Bank in 2004, the conclusions of the policy dialogue meeting held by senior Bank officials with the government-elect before it took office (17-18 January 2005), and specific workshops to discuss the most substantive social issues with the new administration's teams in the ministries and agencies responsible for sector policy. Above all, however, the operation is based on the new government's social strategy. Specifically, the program will support the following actions:

- First, it will support implementation of the new government's package of actions to relieve and address the situation of the neediest segment of the population, which forms part of the National Social Emergency Plan (PANES), and constitutes the strategy it will follow to bring the excluded population into the country's social policy. Although many of the services delivered through the PANES are already provided by the regular line programs of the social ministries, the PANES guarantees that: (i) they will be delivered in an integrated fashion to the poorest segment of the population; (ii) they will supplement new actions to boost family incomes (through conditional cash transfers or temporary employment) and to encourage school attendance or improve housing; and (iii) once the PANES concludes in 2007, this segment, which currently receives none of the social policy's benefits, will be served by the Uruguay's regular social programs.

- Secondly, it will support further expansion of SAF program coverage to include more families from the neediest sectors, including workers in the informal market, poor and adolescent female heads of household, unemployed workers

[7] In accordance with document CS-3633, recently submitted to the Board of Executive Directors, policy-based lending "provides fungible resources to support an agreed program of policy reform and/or institutional changes in a sector or sub-sector. PBLs assist a borrower to develop and implement its economic and sectoral policy reforms and institutional changes to contribute to the achievement of sustainable growth levels and poverty reduction, while addressing actual or anticipated development financing requirements..." (paragraph 2.1). See also document GN-2200-13 of 1 April 2005 (paragraph 3.65).

who have exhausted their unemployment benefits, and pregnant women. Until 2000, only households engaged in the formal sector were eligible for family allowances contingent upon to school enrollment. As of 2000, and especially by late 2004 when Law 17,758 entered into effect, SAF program eligibility was extended to households with workers in the informal sector and others under special conditions.[8]

- Providing universal access to a program originally created for workers in the formal sector is a social policy innovation in the region that will benefit poor households at a very low administrative and targeting cost. Through this innovation, the SAF currently covers nearly 500,000 children with a highly progressive spending distribution. In 2002, the first income quintile captured 46.1% of the benefits, and the second quintile, 31.7%. In contrast, the last quintile captured only 1.4%. The present operation supports extension of the program to unserved, low-income households, as well as the outcome evaluation of the SAF, which will seek to determine, among other things, its cost-effectiveness.

- Thirdly, it will tackle the problems of lack of coordination, segmentation, and overlapping of government social policy actions, which cause inefficiencies and misuse of scarce resources, through the creation of the Ministry of Social Development (MIDES) as a mechanism to coordinate the government's social strategy and facilitate sector monitoring and evaluation.

- Finally, in order to facilitate the effective monitoring and evaluation of social policy, it will support the modernization and updating of basic social data on incomes and consumption, and other basic sociodemographic data, as well as the creation of a single record of beneficiaries.

1.31 It is expected that these measures will upgrade the living conditions of the most vulnerable segment of the population, and improve the coordination and effectiveness of social policy. This will be done with the support of an agency that coordinates social action, using appropriate instruments and information for designing, monitoring, adjusting, and evaluating social policy.

F. Strategy and justification for Bank participation

1.32 **Country strategy.** The objective of the Bank's country strategy with Uruguay, approved in 2000, is to support government policies to achieve, within a framework of macroeconomic stability, sustained GDP growth and greater social equity. The

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[8] Under the new law extending the Family Allowance System to lower-income households (known by its acronym SAF-HMR), beneficiary families receive 16% of the national minimum wage per month for each child under 14 years of age (or under 18, if they are attending school). This corresponds to approximately 230 Uruguayan pesos (about US$10).

core components of the strategy are: (i) initiatives to increase regional competitiveness and integration; (ii) modernization of State and governance, and increased efficiency; and (iii) improvement of social welfare and equity, by targeting the groups most vulnerable to the development process and improving their quality of life. The proposed program aims to develop a social policy that reduces poverty and social exclusion, while improving social welfare and equity, and therefore is comes under the core areas of the Bank's current strategy with Uruguay. It is also compatible with the country dialogue document that served as the basis for discussions with the new government, and which contains the key elements of the new strategy with the country. This document is currently in the approval process.

G. Bank experience with the country and the sector

1.33 The Bank has had extensive experience financing operations in the social sector in Uruguay in the areas of education, municipal development, housing, and water and sanitation (some 30 loan-financed programs). More specifically, in the past five years it has financed programs for education (loans 799, 922, and 1361/OC-UR), health (loan 1348/OC-UR), water and sanitation (785 and 948/OC-UR), housing and municipal and urban development (735, 736, 993, 1094, and 1186/OC-UR), violence and crime prevention (1096/OC-UR), at-risk children (1434/OC-UR), and a social safety net and sustainability loan (1417/OC-UR).

1.34 Execution of these programs has been satisfactory, although their disbursement periods extended longer than originally provided for in the contracts. The programs involving cross-sector participation of government agencies experienced coordination problems, which affected program execution (811/OC-UR and 1186/OC-UR). Nonetheless, the two sector reform programs, for social security and health (921/OC-UR and 1348/OC-UR), successfully avoided this issue by including an interministerial steering committee supported by a technical coordination secretariat.

H. Lessons learned

1.35 This project taps the Bank's experience with social sector programs in the region and in Uruguay, particularly the Health sector reform program conducted between 2001 and 2003 (loan 1348/OC-UR). This operation has also incorporated the recommendations from a review of policy-based loans (PBLs) approved in 2003 by the Bank conducted by the Office of Development Effectiveness; the loans are summarized in document GN-2282-1, which was submitted to the Policy and Evaluation Committee in January 2005.[9] It also draws on the recently approved

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[9] See the document "Análisis de la calidad inicial de los préstamos de apoyo a reformas de políticas aprobados en 2003" [Analysis of the initial quality of loans supporting policy reforms approved in 2003].

guidelines for the preparation of and application for PBLs (CS-3633). The principal lessons and recommendations that shaped the design process are the following:

- The sector assessment and the areas of action were based on analyses conducted by several different institutions, primarily the studies commissioned by the Bank in 2004 that were widely discussed in academic and government circles, and delivered to the new government.[10]

- Simplification of the conditionalities of PBLs, focusing on the key conditions that will help achieve the objectives and ensure sustainability (the program focuses on policy issues that target the most vulnerable and excluded groups, and on institutional coordination. See paragraphs 1.29 and 1.30, which explain the rationale of the operation; see also the policy matrix in Chapter V.)

- Agreement on politically viable and technically feasible conditionalities, programmed in logical sequence that begins with policy approval, continues with progress measurement, and concludes with a performance evaluation (the program has taken into account the priority areas of the new government's social policy, the new ministry, and the social emergency plan, as well as the progress the government has already made in policy setting, despite having taken office so recently. See paragraphs 2.6 and 2.14).

- The financing of reform programs when the political and economic setting is favorable. This will ensure the availability of budgetary resources needed to undertake the change and provide a better social climate, thus minimizing resistance to change (the program will be implemented in the early stages of an administration that enjoys broad popular support and has obtained a strong consensus on the topics on the social agenda).

- Design of an institutional or interagency mechanism to facilitate dialogue and coordination among the agencies involved (see paragraphs 3.2 to 3.6 on the plans for program execution).

I. Coordination with other multilateral agencies

1.36 The Bank has been coordinating program design with other multilateral agencies, primarily the IMF, the World Bank, and the United Nations Development

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[10] In addition to studies by the WB, the United Nations Development Programme (UNDP) and other national and international agencies, the Bank funded and coordinated the following studies on the social sector in 2004-2005: "Pobreza, red de protección social y situación de la infancia en Uruguay" [Poverty, social safety net, and the situation of children in Uruguay], M. Rubio, Coord., et. al.; "Análisis del gasto público social en Uruguay" [Public social spending analysis], (C. Flood, Coord., et al.); "Diagnóstico del mercado de trabajo en Uruguay" [Assessment of the Uruguayan labor market], (C. Pagés, Coord).; and "La ANEP tras un proceso de reforma y dos administraciones" [The ANEP after a reform process and two administrations], (A. Caraballo, Coord. et al.).

Programme (UNDP). As mentioned in paragraph 1.6, the government negotiated a three-year stand-by arrangement (SBA) with the IMF, which was approved last 8 June. The present operation has been included as part of the support package of the multilateral lending agencies participating in the new SBA. In addition, the World Bank agreed with the government to adjust the balance of a 2003 SAL loan (Uruguay, Public services and social sector structural adjustment loan and special structural adjustment loan), and convert it into a new operation entitled Uruguay: Social program development policy loan (SPDPL), for a single tranche of US$75 million. This program was approved by the World Bank's Board of Executive Directors on 10 June this year. During the design stage of that operation, actions were taken to to coordinate with and supplement the present program, thus making the two operations compatible. The SPDLP contains policy actions in the areas of pensions, education, and health; it also aims to strengthen, in coordination with the IDB, the impact assessment of the PANES. Efforts have also been made to coordinate actions with the UNDP, ensuring compatibility in the areas of social welfare, and information and statistics. As far as this program is concerned, the UNDP's contribution will focus on providing technical support to the MIDES and the Instituto Nacional de Estadísticas [National Institute of Statistics] (INE).

II. THE PROGRAM

A. Objectives and description

2.1 The objective of the program is to support the new government in developing and implementing a social policy to reduce poverty, improve the human resource base among the poorest population, and strengthen the institutional framework of the social sector in order to make social policy more effective. The resources freed up by the disbursements will enable Uruguay to fulfill its financial obligations under its agreements with international organizations.

2.2 The proposed program consists of policy actions to alleviate poverty among those most affected by the crisis, and to reform the institutional framework of the social sector. The sector loan is for the amount of US$250 million, to be released in two equal tranches. The conditions for each tranche are set out in the program's policy matrix in Chapter V of this document. The means for verifying the conditions are described in Annex II-1. The relative value of the first release is based on the strength of the measures already adopted by the government, which will contribute to achieving the objectives of this operation. They include, among other things, legislative measures to create the new institutional framework, and the health programs targeting the neediest segments of the population. The relative value of the second tranche is tied to the importance and magnitude of the progress made to comply with the policies adopted and actions taken in the first tranche. The program outcome table can be found in Annex II-2.

B. Policy areas

2.3 The program calls for: (i) stable macroeconomic conditions; (ii) a strategy of immediate and comprehensive actions targeting the population living in extreme poverty and exclusion; and (iii) strengthening of the institutional framework for the coordination, monitoring, and evaluation of social policy.

1. Macroeconomic setting

2.4 As a general program execution macroeconomic condition precedent to the respective tranche releases, the Government of Uruguay must maintain a macroeconomic program that is consistent with program goals. The specific elements of this program are set out in the government's policy letter, which details the commitments in this regard (see Annex II-3).

2. Strategy for serving the poor and excluded population

2.5 The program will support implementation of the government strategy to serve the poorest segment of the population. Two of the actions it has adopted so far in this

connection are the Plan de Atención Nacional a la Emergencia Social [National Social Emergency Plan] (PANES) and the extension of the Sistema de Asignaciones Familiares - Hogares de Menores Recursos [Family Allowance System - Low-income Household Program] (SAF-HMR).

2.6 **The PANES.** The new government has launched the PANES to provide social programs for the population living in extreme poverty and exclusion; funding for it was approved by the legislature in May 2005 (Law 17,869). The PANES intends to cover between 35,000 and 40,000 households (nearly 200,000 people) of the poorest segment of the population below the poverty line, and includes all the country's indigent households. The PANES focuses on households receiving comprehensive assistance in the areas of food and nutrition; primary health care; and the improvement of family incomes through cash allowances provided on the condition that children attend school. It requires that children, adolescents, and pregnant women receive medial attention, and that the household participates in community activities and tasks. The PANES will also strengthen educational services in areas with vulnerable populations through extracurricular support programs, school meals, and transportation allowances for high school students. It will offer temporary employment programs, improve irregular settlements, shantytowns, and pensions, and provide care for the homeless.[11]

2.7 According to age-group estimates, the PANES will benefit 43,000 children under six years of age, 41,000 children between the ages of six and 12, 25,000 adolescents (13 to 17 years), 68,000 adults between 18 and 64 years, and 23,000 senior citizens. All beneficiaries will receive nutrition and health care, one third will have school support programs, and 150,000 will receive some type of assistance to improve the conditions of their makeshift dwellings. The incomes of PANES beneficiaries will be improved under the citizen income component (a conditional cash transfer), and the temporary employment component. The first will benefit 35,000 households, the latter 16,500 adults.[12]

2.8 The households included in the PANES are selected by applying the Critical Deficiencies Index (ICC) developed for the Ministry of Social Development (MIDES) by the University of the Republic. The ICC combines noncash variables that are highly effective in predicting families' real incomes. An analysis of

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[11] The environmental strategy for PANES actions in irregular settlements will be consistent with the environmental strategy of the program UR-0123 "Integration of irregular settlements," approved in 1999 and currently in execution.

[12] The citizen income component will provide heads of households with approximately US$50 per month provided they meet the counterpart conditions of education and health for the duration of the PANES. The temporary employment component will benefit 16,500 adults who will receive approximately US$75 per month for a maximum 12 months. To avoid overlaps, households with family members involved in the temporary employment component will stop receiving the citizen income as long as benefits are received under the temporary employment component.

Encuesta Continua de Hogares [Ongoing Household Survey] (ECH) data provided the basis for the selection of the variables. The ICC is calculated using data obtained from a survey of the households applying for PANES benefits.

2.9 The PANES costs an estimated US$200 million and will last 24 months. When the program concludes, PANES beneficiaries will be absorbed by the different line programs offered by social sector ministries and institutions. To this end, the national health, education, and housing plans being prepared, and which are the responsibility of the Ministry of Public Health (MSP), the National Public Education Administration (ANEP), and the Ministry of Housing, respectively, provide for the inclusion of the PANES beneficiary population not currently receiving their services. The MIDES and the Oficina de Planeamiento y Presupuesto [Planning and Budget Office] (OPP) are exploring alternatives to ensure adequate incomes for the households that need this support. Alternatives include specific support for microenterprises under the Microfinance strategy in Uruguay program (UR-P1034) being designed by the government with the Bank; jobs in public works programs planned by the government; proposals for creating direct grants or fellowship programs to keep youths in school; increasing the SAF-HMR benefit for poor households; and the ongoing actions by the MIDES to address the specific problems of population groups affected by structural poverty. Funding to cover the transition of PANES beneficiaries to the ministries' permanent programs, or for the new actions, will be included in the five-year budget (2005-2009).

2.10 As a condition precedent to the first disbursement, the government agrees to submit the law in effect that established the PANES and allocated the funds for its implemention; the current decree regulating the citizen income component; and the execution timetable for the rest of the plan's components. It will also deliver the design and the action plan for conducting the performance evaluation of the PANES and the SAF-HMR. For the second disbursement, the government will: (i) demonstrate that the PANES beneficiary database, control system for the counterpart conditions, and payment mechanisms are operating satisfactorily; (ii) submit a progress report on the performance evaluation of the PANES and the SAF-HMR; and (iii) submit the strategy for incorporating PANES beneficiaries into new or ongoing social sector institution programs.

2.11 **Extension of SAF-HMR coverage.** The program will support efforts to extend the coverage of the SAF-HMR to workers in the informal market, pregnant women, poor female heads of household and/or teenage and unemployed mothers with children, provided they meet counterpart conditions in health and education, as provided for under Law 17,758 of 2004.[13] In the coming months, this expansion

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[13] Pursuant to Law 17,758 of 2004, to be eligible for the benefit, households may not receive income of any kind amounting to more than three minimum wages.

will benefit at least 105,000 children in low-income households. Beneficiary families will receive 16% of the national minimum wage per child under 14 (or under 18, if they are still enrolled in school). To obtain the benefit, the families must ensure that their children attend school and receive health checkups through the national emergency health program (vaccinations, well-child checkups, and prenatal checkups). The Banco de Previsión Social [Social Security Bank] (BPS) will be responsible for checking that the counterpart conditions are met.

2.12 Submission of the plan for including all eligible families in the SAF-HMR in 2005-2006 is condition for the first disbursement. For the second disbursement, the government must demonstrate that at least 105,000 children from poor households have been included in the SAF-HMR, pursuant to Law 17,758 of 2004.

3. New institutional framework for social sector coordination

2.13 The program supports the government's actions to establish a new institutional framework for the coordination, monitoring, and evaluation of social policy. Specifically, this means the creation, operation, and consolidation of the MIDES; creation of a Single Record of Beneficiaries (RUB) for the PANES; and the updating and improvement of social data through adjustments in the ongoing surveys and new surveys.

2.14 **The new institutional framework.** One of the first measures taken by the new administration was to submit to the legislative branch a proposal to create the Ministry of Social Development (MIDES), which was approved by Law 17,866 on 21 March 2005. The program recognizes the progress made toward establishing a new institutional framework for the social sector with the creation of the MIDES, and will support its implementation. Some of the core responsibilities of the MIDES are: (i) to advise the government on social policy design; (ii) to coordinate intersector actions, plans, and programs designed to guarantee the full exercise of citizens' social rights (education, health, housing, work, social security, nutrition, and gender equity); (iii) to develop and operate a social data system to facilitate the design of policies and actions for tackling social problems, more accurate targeting of interventions, and the monitoring and evaluation of sector activities; and (iv) to design and manage a single selection and registration system for the program's beneficiary families. The MIDES will also execute and coordinate programs to address the social emergency, including the PANES. Finally, a Social Cabinet made up of sector authorities will be created to improve coordination of central government action in the social sector, and to support the MIDES in its coordination efforts.

2.15 The policy actions for the release of the first tranche are the following: the current law creating the MIDES, the law establishing the Social Cabinet, and the action plan for establishing and strengthening the Territorial Coordination and Program Evaluation Divisions. The purpose of the Territorial Coordination Division is to

establish a mechanism for linking the actions of national and local social agencies in Uruguay's territorial units. The aim of the Program Evaluation Division is to improve the ongoing monitoring and evaluation of the national government's principal social programs, including the PANES and the SAF-HMR, in order to provide feedback for policy decisions. For the second tranche, the government must demonstrate that the functions of coordination, monitoring, and evaluation are firmly established in the MIDES and operating in accordance with the aforementioned action plan.

2.16 **Single record of beneficiaries (RUB).** The program will support the government's actions to establish a single record of PANES beneficiaries. The record is currently being developed by the MIDES, with technical assistance from the University of the Republic. This involving compiling and crosschecking data on the families and individuals applying for benefits under the PANES with the information in the databases of the BPS, and the Ministries of Health (State Health Services Administration), Education, and the Interior. The RUB will be used for monitoring the plan and the counterpart responsibilities of its beneficiaries.

2.17 For the first disbursement, ministerial regulations establishing and regulating the operation of the RUB must have been approved, and a technical proposal submitted describing the systems for updating and providing feedback on same. For the second release, all PANES beneficiaries should have been included in the RUB.

2.18 **Updating social data.** Data on the social sector and the quality of life of the population will be updated by: (i) conducting an Encuesta de Ingresos y Gastos de Hogares [Household Income and Spending Survey] (EIGH) to ascertain what changes have occurred in consumption habits and in the income structure of the population over the last period (the last EIGH was carried out ten years ago); and (ii) conducting an Encuesta de Hogares Ampliada [Extended Household Survey] (EHA) in 2006 (sampling approximately 100,000 households) that is representative for the nation as a whole, the departments, smaller towns, and rural and urban areas, including those with less than 5,000 inhabitants, in order to obtain reliable and up-to-date data on the country's principal sociodemographic variables and households' living conditions, since the next national population census has been postponed until 2010; and (iii) adjusting the ECH to include rural areas and settlements of less than 5,000 inhabitants.

2.19 For the first tranche release, the government must submit the design of the sample and the EIGH form, as well as the action plan for implementing the EHA. For the second, the EIGH and the EHA should be in execution. In addition, the government must submit its proposal for revising the ECH, including its extension to rural areas and settlements of less than 5,000 inhabitants, and demonstrate that it is being funded in the five-year budget law.

C. Cost and financing

2.20 The cost of the Program is US$250 million from the Bank's Ordinary Capital. The loan will be released in two tranches of US$125 million each, subject to fulfillment of the conditions described in the program's policy matrix. The first tranche is expected to be released in August-September this year, and the second in the first quarter of 2007. The total amount of the loan was determined by consensus between the government and the Bank, and was based on the country's needs, the Bank's loan program for Uruguay over the coming years, and the financing strategy agreed to under the new stand-by arrangement (SBA) with the IMF. The tranches' focus was considered the most appropriate because the details of the policy measures of the operation are already known.

2.21 The financing terms follow:

Table II-1

Source of Financing:	Ordinary Capital
Amount:	US$250 million
Conditions:	
Amortization period:	20 years
Grace period:	5 years
Disbursement period:	Maximum 24 months
Interest rate:	Variable
Inspection and supervision fee:	*
Commitment fee:	0.25% on undisbursed amounts
Currency:	United States dollars – Single Currency Facility

* With regard to the inspection and supervision fee, in no case will the charge exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

III. PROGRAM EXECUTION

A. Borrower

3.1 The borrower will be the Eastern Republic of Uruguay. The executing agency will be the Ministry of Economy and Finance (MEF).

B. Program administration

3.2 To ensure effective and timely fulfillment of the actions set out in the policy matrix, the MEF will sign agreements with the Oficina de Planeamiento y Presupuesto [Planning and Budget Office] (OPP), the Ministry of Social Development (MIDES), the Banco de Previsión Social [Social Security Bank] (BPS), and the Instituto Nacional de Estadísticas [National Institute of Statistics] (INE), establishing the specific responsibilities of each in the program.

3.3 To ensure effective coordination of actions, an interagency committee (CIP) will be set up for the program, involving the authorities of the aforementioned agencies. It will meet periodically and be chaired by the MEF.

3.4 The MEF will establish a program coordinating unit (PCU), which will consist of a technical team comprised of MEF, MIDES, and OPP staff, in which other agencies involved in the program may participate at the discretion of the executing agency. The PCU will be the executive body responsible for the administration, technical monitoring, and overall evaluation of the program. It will report on the outcome of its management directly to the CIP and coordinate efforts with the Bank. To this end it will: (i) supervise the execution of agreements with the agencies responsible for the program's policy actions; (ii) compile and submit to the Bank the information required for authorizing each tranche's release, after collecting and checking the background information and documents needed to demonstrate fulfillment of the policy actions agreed to in the loan agreement; (iii) serve as principal technical liaison between the government and the Bank; (iv) manage the rapid disbursement resources in accordance with Bank rules for sector loans; (v) follow up on the program's monitoring and evaluation plan to facilitate compliance with agreed policy actions; and (vi) prepare the reports needed for Bank missions and a final evaluation report on the program.

3.5 Taking into account the agreements to be signed, the PCU will have a simple and straightforward management structure with a coordinator responsible for ensuring that the operation progresses smoothly. PCU staff may be involved on a part-time basis in this operation. The PCU will seek to maintain and tap the experience and lessons learned from other Bank-financed programs in Uruguay (social security reform and health sector reform).

3.6 To ensure fulfillment of the policy actions agreed to in the loan contract, and the PCU's other responsibilities as liaison with the Bank, the agreements will specify terms and deadlines so that the PCU can process the tranche release authorization requests with the Bank in timely fashion. The loan contract, the policy matrix, the means of verification matrix, and the program monitoring and evaluation timetable will be regarded as integral parts of the agreements.

C. Execution timetable and conditions for processing tranche releases

3.7 The program will be executed during a maximum term of 24 months. The sector loan proceeds will be released in two equal tranches, the first being scheduled for the third quarter of 2005, and the second for the first quarter of 2007.

3.8 The borrower must meet the following conditions, to the Bank's satisfaction, for release of each tranche. It must: (i) maintain a macroeconomic environment consistent with program objectives and the agreements with the IMF; (ii) fulfill the policy actions agreed to for the respective tranche, as specified in Chapter II and Annexes I-1 and II-1 to this document; and (iii) keep a special bank account open in which the Bank will deposit the loan proceeds.

3.9 Further conditions precedent to the first disbursement will be to demonstrate that: (i) the PCU and CIP are in operation; and (ii) the agreements have been signed with the OPP, the MIDES , the BPS, and INE.

3.10 The borrower, through the executing agency, will be responsible for maintaining accounting and financial records on the use of loan proceeds, and for preparing and submitting the applications for tranche releases, ensuring that these documents are available for future inspections by the Bank and/or by independent auditors previously accepted by the Bank. The borrower must maintain a special bank account for managing the loan proceeds, and must submit information on this account to the Bank the before the first disbursement can be made.

3.11 In requesting authorization for the disbursements, the project team will assess the information submitted by the Uruguay in fulfillment of the agreed policy actions, and prepare the corresponding reports for the Bank's Management and Board of Executive Directors, pursuant to current policy.

D. Monitoring and evaluation

3.12 Program progress will be monitored through meetings held every six months, based on semiannual reports that reflect compliance with the policies set out in the matrix, identify problems and risks, and propose measures for addressing with them. The semiannual timetable for monitoring program progress can be found in Annex III-1.

3.13 The executing agency will also evaluate the performance of the PANES and of the extension of the SAF-HMR program. The evaluation will make it possible to

ascertain the impact of these programs on the beneficiary population, and determine the relevance and effectiveness of the targeting and the managerial and administrative processes. It will also furnish recommendations for improving program operation. The design of the evaluation and the action plan for conducting it are among the conditions precedent to the first disbursement. Lastly, Annex II-2 contains the program outcome table with indicators, their baseline values, estimates for the second tranche, and estimates for one year after the program concludes. The data and the calculation methodology used to measure the indicators will be available for an eventual ex post evaluation by the Bank.

E. Policy letter

3.14 The Bank agrees with the borrower on the macroeconomic and sector policies described in the policy letter (Annex II-3) submitted by the MEF. The policy letter contains the main elements of the government's strategy and the policies that are being implemented to guarantee suitable macroeconomic conditions consistent with the program's objectives, government priorities for the social sector, and the commitment to execute the policies set out in the policy matrix agreed upon by the Bank and Uruguay within the context of this program.

F. Procurement of goods and services

3.15 The rapid disbursement resources of the social sector loan may be used to finance the aggregate cost, in foreign exchange, of eligible imports from Bank member countries. Bank procedures governing sector loans, which do not require international competitive bidding, will apply in this case. The funds will be disbursed at the request of the borrower provided all contractual conditions have been met to the Bank's satisfaction.

G. External audit

3.16 The Bank reserves the right to request that the borrower submit financial reports on the use of loan proceeds, certified by independent auditors accepted previously by the Bank.

H. Inspection and supervision

3.17 The Bank will establish the inspection procedures it deems necessary to ensure satisfactory execution of this sector loan. In this connection, the borrower will cooperate fully by providing all necessary assistance and information.

IV. FEASIBILITY AND RISKS

A. Institutional and fiscal feasibility

4.1 To ensure institutional feasibility, this operation has taken into account the successful experiences of previous similar operations in Uruguay. It has also adopted an execution mechanism that clearly defines the governing, executive, and administrative responsibilities (Ministry of the Economy and Finance (MEF) and the Oficina de Planeamiento y Presupuesto [Planning and Budget Office] (OPP)), as well as technical and operational responsibilities (Ministry of Social Development (MIDES), the Instituto Nacional de Estadística [National Institute of Statistics (INE), and the Banco de Provisión Social [Social Security Bank] (BPS)), in accordance with each agency's jurisdiction, through agreements on the implementation of program policies.

4.2 The mutual interest of securing the disbursements serves as an incentive for the agency responsible for the financial programming of external resources and the budgetary programming of public spending (MEF), and the institution responsible for monitoring their execution (OPP), to support the implementation of policy actions by the agencies that are technically and operationally responsible for them (MIDES, INE, and BPS). In addition, because of the magnitude of the challenge of implementing these actions, MIDES, INE, and the BPS authorities have built the line agencies directly involved in executing policy actions into the program's technical and operational structure to ensure their effective involvement and commitment to the operation's success.

4.3 This program is compatible with the stand-by arrangement (SBA) between Uruguay and the IMF to recover basic macroeconomic equilibrium. In this connection, there was close coordination with the IMF to monitor macroeconomic conditions so as to ensure that they are consistent with the aforementioned arrangement. With regard to coordination with the World Bank, this operation is consistent with and has been coordinated with the activities of the Uruguay: Social program development policy (SPDPL) loan, which was submitted to the World Bank's Board of Executive Directors on 10 June 2005.

4.4 **Fiscal impact of the PANES.** For estimating the fiscal impact of the Plan de Atención Nacional a la Emergencia Social [National Social Emergency Plan] (PANES), the government calculated a total cost of US$200 million, with US$70 million corresponding to 2005 (only eight months of the year); US$100 million to 2006, and US$30 million to 2007. Uruguayan authorities have indicated that this will be the only significant increase in public spending in 2005, given the financial constraints imposed by the high level of debt.

4.5 Fiscal targets agreed upon with the IMF for the next three years (see Frame of Reference) have already factored in the cost of the PANES, the annual outlays for which represent 0.4% of the GDP. While it is true that the fiscal situation offers little leeway, if the economy continues to grow as expected, and increases in discretionary spending and investment are controlled, no major difficulties are envisaged for meeting the SBA's targets.

B. Benefits

4.6 The program will provide different types of benefits. First of all, significant short-term improvements are expected in the incomes of the 200,000 people served by the PANES, and in their access to key services, which will be contingent upon meeting counterpart conditions in health and education; this will reduce poverty and social exclusion. In addition, the registro unificado de beneficiarios [single record of beneficiaries] (RUB) of the PANES will make it possible to identify, monitor, and assess, on a case-by-case basis, program impact (a conditionality of the program) on Uruguay's most vulnerable families.

4.7 Secondly, with the expansion of family allowances, a permanent income-supporting mechanism is created for the poorest households with children, and by meeting the conditions for receiving this allowance, the children will receive a better education. Program conditionalities will not only extend the Sistema de Asignaciones [Family Allowance System] (SAF) to all poor households, but also establish the impact assessment of the benefits, including an assessment of the impact of the transfer amount.

4.8 Thirdly, the creation and establishment of the MIDES as a mechanism for coordinating social policy will enable the government to intervene more effectively in the social sector. The MIDES is expected to become a technically and operationally competent institution not only for coordinating social policy, but also for designing new policies, evaluating programs, and operating an information system to be used to upgrade existing programs. A combination of the above will provide an effective social safety net for addressing social challenges in Uruguay.

C. Poverty-targeting and social equity classification

4.9 This operation qualifies as a social equity enhancing project, as mandated by the Bank's Eighth Replenishment (document AB-1704). Because it is a policy-based loan*,* it does not qualify as a poverty-targeted investment.

D. Social and environmental impact and proposed measures

4.10 Given the nature of the operation, no negative social or environmental impact is expected. The present operation was reviewed by the Committee on Environment and Social Impact (CESI) at its 22 April 2005 meeting and includes its observations and recommendations.

E. Risks

4.11 The incipient capabilities of the MIDES for carrying out administrative functions (beneficiary identification, payment of allowances, oversight of counterpart conditions, etc.), evaluations (such as the evaluation of the PANES), and policy design (development and implementation of an exit strategy) constitute one of the operation's risks. Accordingly, the government has designed a strategy to create and strengthen the necessary capacities at the MIDES. The core component of the MIDES is already fully operational and focused on implementing the PANES; its other technical units are being organized. The MIDES's operating budget is guaranteed for this year, and the 2005 Balanced Budget, Accountability, and Amendment Law will appropriate the necessary funds for strengthening the territorial social policy coordination units and the monitoring and evaluation units. The OPP and the MIDES are calculating the resources and institution-strengthening activities that will be needed for next year and the remainder of this government's term, so as to include them in the five-year budget slated for approval in November 2005. In addition, the OPP (with support from the Comité Ejecutivo para la Reforma del Estado [Executive Committee for State Reform] (CEPRE)), the BPS, and the INE are transferring to the MIDES the technical expertise they gained in recent years while coordinating, managing, and evaluating social policy, by providing direct technical assistance in selecting beneficiary families for the PANES, implementing the RUB, and delivering benefits, among other things.

4.12 Although the authorities have stressed that the PANES will not continue past 2007, international experience with plans involving cash allowances has demonstrated that termination of these benefits requires political determination, a capacity to establish transition plans, and, even with these conditions in place, gradual implementation of change. These factors pose a latent risk for the PANES which, after two years of operation, might surely have created considerable political, institutional, and fiscal pressure. The present program seeks to attenuate this possibility by developing a clear strategy for moving PANES beneficiaries to other social programs, accompanied by the necessary budget allocation (see paragraph 2.9). At the same time, however, the program intends to protect the most vulnerable families from the potential harm of having to leave the PANES, should the social situation that originally gave rise to their involvement in the program continue or worsen. This is why one condition of the operation is the evaluation of PANES beneficiaries at the program's conclusion in order to measure to what degree their social situation has improved, and to identify alternative forms of support.

V. POLICY MATRIX

Problem	Policy	First tranche	Second tranche
I. Macroeconomic environment			
Heavy debt and pressure on the budget to repay the debt. Growing poverty, high unemployment, and limited impact of economic growth on job creation.	To maintain fiscal balance while supporting the most disadvantaged social sectors.	The government develops a strategy for ensuring macroeconomic conditions that are consistent with program targets.	Macroeconomic conditions continue to be consistent with program targets.
II. Strategy for serving the population living in poverty and exclusion			
No linkage exists among programs targeting poor and excluded segments of the population, which have grown during the crisis.	Program of immediate and comprehensive actions targeting the population living in poverty and exclusion	Law passed establishing the Plan Nacional de Atención a la Emergencia Nacional [National Social Emergency Plan] (PANES) and allocating resources for its implementation; decree approved regulating the citizen income component; and execution timetable prepared for the remaining components of the Plan. Commitment by the Ministry of Social Development (MIDES) and the Banco de Provisión Social [Social Security Bank] (BPS) to evaluate the outcomes of the PANES and the Sistema de Asignaciones Familiares-Hogares de Menores Recursos [Family Allowance System - Low-income Households] (SAF-HMR), respectively, and to design and develop an action plan for the evaluation.	Evidence that the following PANES systems are in operation: (i) beneficiary database; (ii) oversight of counterpart conditions; and (iii) audited payment reports. Inclusion of the resources for the operation of the PANES in the five-year budget (2005-2009). Progress in conducting the evaluation of the PANES and the SAF-HMR. Strategy for including PANES beneficiaries in social sector institutions' permanent programs.
High levels of poverty among children (58% of children from 0-5 below the poverty line) and well-designed social programs in operation, but providing insufficient coverage.	To extend coverage of the Family Allowance System to female workers in the informal market and to poor , female heads of household and teenage mothers.	Plan for including all eligible families in the Family Allowance System (HMR- low-income households).	At least 105,000 children of poor households covered by the SAF-HMR, following the entry into force of Law 17,758 on 4 May 2004.

Problem	Policy	First tranche	Second tranche
III. Strengthening the social sector's institutional framework			
Fragmentation and lack of coordination in government actions in the social sector.	To create a new institutional framework for coordinating, monitoring, and evaluating social policy.	Law passed creating the Ministry of Social Development (MIDES). Decree establishing the Social Cabinet Action plan for establishing and strengthening the MIDES's offices of program evaluation and territorial coordination, containing information on the institution's mission and functions, and a minimum headcount and equipment, with their estimated costs.	Coordination, monitoring, and evaluation functions established in the MIDES.
Data on the beneficiaries of the government's social programs is incomplete, of varying quality, and scattered throughout the different institutions of the sector.	To provide support for creating a registro único de beneficiarios [single record of beneficiaries] (RUB) for government social programs that target extreme poverty.	Ministerial regulations approved for establishing and regulating the operation of the PANES's RUB, together with a report on the process of generating the RUB.	All PANES beneficiaries included in the RUB.
Dated and incomplete information on living conditions and poverty, household income and spending, and population and housing.	To update information through both adjusted and new surveys.	Sample and form designed for the Encuesta de Ingresos y Gastos de Hogares [Household Income and Spending Survey] (EIGH). Action plan for implementing the Encuesta de Hogares Ampliada [Extended Household Survey] (EHA).	EIGH under way. EHA under way, and including data on the labor market and household incomes that take into account rural areas and urban settlements, including those with fewer than 5,000 inhabitants. Proposed review of the Encuesta Continua de Hogares [Ongoing Household Survey] (ECH), including its extension to rural areas and to settlements of less than 5,000 inhabitants.

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PROPOSED RESOLUTION

Uruguay. Loan ____/OC-UR to the Eastern Republic of Uruguay
Social Sector Program

The Board of Executive Directors

RESOLVES:

That the President of the Bank, or such representative as he shall designate, is authorized, in the name and on behalf of the Bank, to enter into such contract or contracts as may be necessary with the Eastern Republic of Uruguay, as Borrower, for the purpose of granting it a financing aimed at cooperating in the execution of a social sector program. Such financing will be in the amount of up to US$250,000,000, from the resources of the Single Currency Facility of the Bank's Ordinary Capital, and will be subject to the Financial Terms and Conditions and the Special Contractual Conditions of the Executive Summary of the Loan Proposal.