THE WORLD BANK

CONFIDENTIAL

LOAN COMMITTEE

LC/M/86-33
October 23, 1986

Minutes of the Loan Committee Meeting to consider URUGUAY - Proposed Structural Adjustment Loan held on October 20, 1986, in Conference Room E-1208

A. Present

Committee:		Others:	
Chairman:	Mr. Stern	Messrs/Mmes.	Dubey
Finance:	Mr. Wood		Rogers
Legal:	Mr. Shihata		Fox
ERS:	Mr. Michalopoulos		Picciotto
OPS:	Mr. Köpp		Pfeffermann
Region:	Mr. Gué		Clements
			El Maaroufi
			Donovan
			Nankani
			Marshall
			Giral
			Collell
			Cucullu

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COMMITTEE
Senior Vice President, Operations (Chairman)
Senior Vice President, Finance
Vice President & General Counsel
Vice President, Operations Policy
Regional Vice President concerned*
Vice President, Energy & Industry (for lending in these sectors and SALs)
Vice President, Economics and Research (for non-project lending)

OTHERS
Standard (see OMS 9.25 page 7)

*Copy to all other Regional Vice Presidents

B. Issues

1. The meeting was called to discuss the Initiating Memorandum attached to Mr. Knox' memorandum of October 9, 1986 for a Structural Adjustment Loan to Uruguay. This discussion focussed on the main issues raised in the Country Policy Department's memorandum of October 17, 1986.

C. Discussion

Macro-Economic Framework

2. The meeting discussed the status of preparation of a medium-term macroeconomic framework for the Uruguay economy. The Region noted the Government's progress in developing a macro-economic framework and the importance of the political agreement it has reached with the opposition parties on the development program. The Committee stressed the need for an agreement with Uruguay on macroeconomic projections to establish clearly the framework for the medium-term program. The Region noted that it plans to prepare a medium-term framework paper towards the end of the fiscal year, and agreed that during appraisal of the SAL the macroeconomic framework would be further discussed with the Government.

3. The Chairman stressed that the Region should convey to the IMF and Uruguay the importance for the Bank of there being an IMF stand-by agreement with Uruguay, rather than only Article IV consultations or enhanced surveillance arrangements, to ensure the maintenance of a sound macro framework for a SAL program.

Program Contents

4. The Committee noted that the SAL operation should include an agreement with Uruguay on the level and composition of public investment as well as on investment criteria. Besides social security and financial reform, the program also needs to reflect other major areas of economic policy, notably on the trade regime, exchange and interest rates and fiscal issues.

5. With respect to the technical assistance component of the SAL operation, it was agreed that this should be presented as a separate operation.

Social Security Reform

6. The meeting discussed the Region's proposals for social security reform. The Region noted that the proposed reform would entail the provision of an affordable and equitable level of benefits to reduce the fiscal burden and ensure the viability of the system in the future. Questions were raised about the employment, savings and transfer impact of the reform. The Region indicated that the reform will be positive for savings, both private and public, and neutral for relative prices of capital and labor, while reducing Government transfers. The Chairman emphasized the need for more specific answers on the impact on incentives. He also underscored that the design of the revised system should take

account of experience with social security reform in other countries, and suggested that assistance should be obtained from consultants with this expertise.

7. There was discussion of the proposed conditionality of the SAL with respect to social security reform. The Committee supported the view that Second Tranche disbursement should not take place before legislation is approved. It was agreed that a formula should be found similar to that followed in the Argentina Agricultural Sector Loan, whereby the performance indicators established in the Loan Agreement implicitly require approval of legislation.

Financial Sector

8. The meeting discussed the solvency of banks, the potential impact on the economy, and the distribution of losses, including previous portfolio purchases by the Central Bank. The meeting agreed that, as a matter of general principle, the Government should not take over private losses. Clear criteria should be agreed to determine the nature of government intervention in the event of local bank failures.

9. The meeting discussed the spread between deposit and lending interest rates. It was noted that the high level of spreads indicated the existence of controls on competition or some other form of market impediment. The Committee agreed that this problem should be explored further by the Region and that conditionality should be developed as appropriate.

10. It was agreed that the Region would also explore the possibility of legislation permitting debt/equity swaps and debt conversions, though it was recognized that these may be of limited relevance in the Uruguayan context.

Trade Reform

11. A question was raised about official reference prices. The Region indicated that this issue will be covered in the study of tariff reforms nearing completion, which will be used for guidance on this matter. The Committee agreed that the trade reform should eliminate those reference prices which are not clearly justified and that the remaining ones should be very specific and limited in number. Where reference prices are used to prevent dumping, alternative anti-dumping devices should be explored.

12. It was noted that export incentives should be generalized and not confined to specific categories of goods. The matrix should conform to the language in the Government's letter of development policy in this respect.

D. Conclusion

13. Subject to the modifications noted above, the Committee approved the Region's proposal to proceed with the appraisal of a SAL along the lines set out in the Initiating Memorandum. It also approved a loan amount of US$80 million.