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SD2009-0003

March 9, 2009

FROM: Vice President and Corporate Secretary

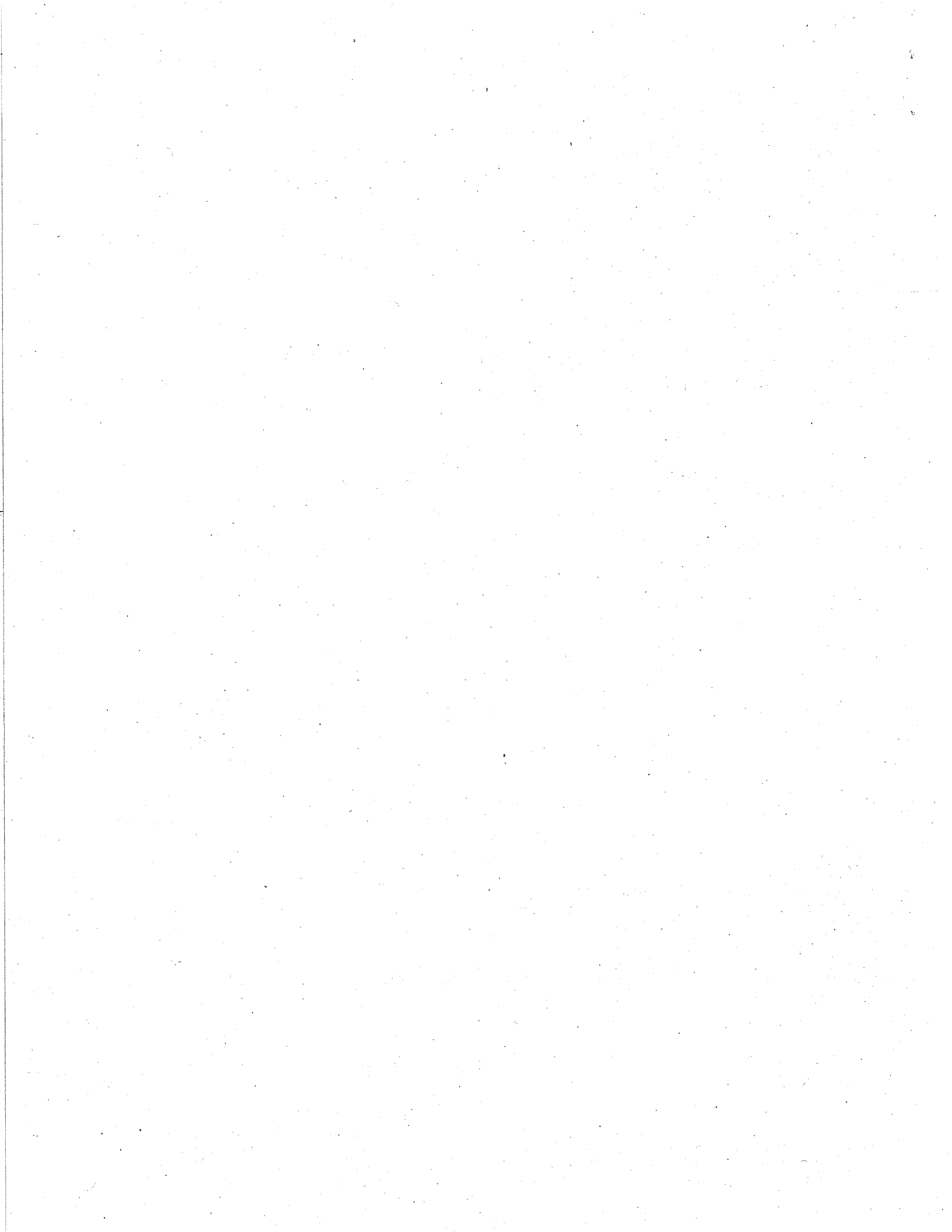
Summary of Discussion at the Meeting of the Executive Directors
of the Bank and IDA, February 3, 2009*

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* This summary consists of staff notes of the discussion and is not an approved record.

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URUGUAY – SECOND PROGRAMMATIC REFORM IMPLEMENTATION DEVELOPMENT POLICY PROGRAM

1. Executive Directors approved a loan of US\$400 million to Uruguay for the Second Programmatic Reform Implementation Development Policy Program (PRIDPL II) (R2009-0005 and R2009-0005/1, dated January 9, 2009).

2. **Chairman's Introductory Remarks.** The Chairman observed Directors' ongoing questions about the Bank's framework for its response to the financial crisis. It was clear that the world was facing an unfolding crisis, the severity and depth of which was not yet fully known. In this uncertain situation the Bank's aim had been to support its borrowers to reduce vulnerabilities, to sustain development expenditures, and to minimize impacts on the poor. Due to the Bank's sound financial base, it was able to accommodate borrowers' requests for financing. On the IBRD side, management was using an exposure framework which was presented to the Audit Committee on January 21 and to the Board on January 22. This framework maximized the safe use of capital and was based on country allocations that considered Gross National Income, population and risk, while preserving Country Partnership Strategies (CPS). It was responsive to demand through reallocation away from countries with limited or no demand to those interested in more IBRD borrowing. The framework also allowed the Bank to assess all financing requests in an equitable and transparent way, to continuously monitor remaining country and portfolio headroom, and to reallocate capital dynamically. Management was tracking this process closely and would make adjustments as needed.

3. The Chairman said that management was committed to keeping the Board apprised of the framework as it evolved, and had provided comprehensive briefings. There would be future opportunities for the Board to discuss the Bank's response to the financial crisis..

4. **Staff Introduction.** Staff described the backdrop to the proposed operation, commenting that in line with government priorities, this operation supported the implementation of three key policy areas of the government's program – tax reform, improvements in the business climate and enhanced social protection. Progress in implementing the program had been excellent. The proposed operation was confirmed with the authorities as part of the CAS Progress Report in December 2007. It drew on interim reports prepared by Bank staff in collaboration with the Uruguayan authorities in all three focus areas, including a Poverty and Social Impact Assessment (PSIA) on tax reform, an investment climate analysis, workshops with labor and business representatives, and several non-lending technical assistance and analytical reports on the social security safety net system. The operation remained within the overall CAS lending ceiling endorsed by the Board in the April 2008 CAS Progress Report. Although the operation had a deferred drawdown option (DDO) feature, the authorities had informed staff that they planned to draw down the full amount of the loan in coming weeks. The operation was precautionary, reassuring markets on Uruguay's commitment to sound economic policies and its access to finance during the global economic crisis.

5. Staff noted that there was an ongoing dialogue on macroeconomic developments between the authorities and the IMF. The authorities had not requested support from the IMF, but had informed staff that they would be open to engagement with the IMF if necessary. The Bank had worked closely with the IDB which would provide similar amounts of financing over coming months, as well as with the IMF and Corporacion Andina de Fomento (CAF).

6. The Chief Economist for LAC said that when looking at reasons for Uruguay coming to the World Bank for a significant amount of lending, it was important to understand that the situation in Latin America was different than experienced during other crises, such as in 1998 or 2002. In those crises, accumulation of unsound domestic policies had led to heightened vulnerabilities. The current situation was a different phenomenon. For the past ten years, the region had pursued relatively sound macroeconomic policies, and had made significant gains with social indicators, human capital investment and institutional improvements to enhance the regulation of financial systems. However, like the rest of

the world, the region was now suffering from the impact of the financial crisis, which was centered on the policy mistakes of primarily richer countries. This was not a crisis of international reserves, when the IMF would be the natural institution to approach. Further, during the 1990s, many LAC central banks passed laws restricting their ability to transfer resources to the budget. It was typically central banks that borrowed from the IMF to deal with international reserve and exchange rate problems, but in the current situation governments needed budget support. These countries probably wished to avoid coming to the IMF first, given that this could be perceived as signal of a home grown problem, which was not the case in the current situation. Another reason why countries might be approaching the World Bank first was the wish to deal with external shocks without sacrificing long-term goals. The Bank could help sustain and even try to improve the structure of policy frameworks. Some of the governments that were borrowing from the World Bank were also interested in onlending to the real sector, which was facing shocks from reduced exports.

7. Staff's detailed written responses to speakers' written statements are summarized below.

8. **Support for DPL.** A number of speakers thanked staff for the comprehensive document and commended the team for its fast response to Uruguay's needs in a rapidly deteriorating environment. They noted that over the past few years, Uruguay had made significant progress with the development and implementation of its macroeconomic and structural policies. Since 2002, it had maintained a broadly appropriate fiscal stance and sound debt management practices to improve the debt profile, diversify its export markets and strengthen the financial system. A large number of speakers commented that the reforms supported by the proposed operation addressed important vulnerabilities and would help to strengthen Uruguay's resilience, and they endorsed the proposed operation.

9. Several speakers noted that the DPL objectives were closely linked to the country strategy and that the reforms backed by this operation would further strengthen the Uruguayan economy and reduce the risk of a contractionary fiscal stance as external demand fell. Some speakers strongly concurred with management's assessment that the triggers for this second operation had been met, and commented that the document showed how Uruguay was making significant economic and social reforms through this series of PRIDPLs. A speaker welcomed the conclusions of the latest IMF Article IV consultation, in particular findings about the country's improved preparedness to withstand external shocks, and was interested in the latest information on the current macroeconomic situation.

10. Some speakers welcomed that lessons from Uruguay's experience had been incorporated in the DPL series. One of them encouraged strategies to enhance and sustain country ownership.

11. Some speakers thanked staff for informative bilateral meetings. Speakers wished the government success in implementing the DPL.

12. **DDO.** A number of speakers asked about the rationale for choosing a DDO option for this operation given the intention to withdraw the total amount of the loan in FY09 to preserve cash balances. Some other speakers commented that the decision to disburse the loan in a single tranche upon effectiveness seemed appropriate under the circumstances. Combined with the financing anticipated from other multilateral creditors, World Bank financing would support Uruguayan efforts to reduce refinancing risks in line with the debt management strategy.

13. Staff said that initially the DDO feature was deemed appropriate as the authorities wanted a source of liquidity over a longer-term period to maintain ongoing structural programs if a financing need materialized. However, as external conditions evolved, debt management priorities shifted to securing preventative financing.

14. A speaker asked for management's best estimate on when this loan would be available for drawdown. He noted that many recent operations under the DDO had been disbursed very quickly, and he asked if any lessons had been found about use of this instrument in its precautionary function and about the implications for pricing. He also asked about the policy monitoring relevance of the Letter of Development Policy in the context of an immediate disbursement of the DDO.

15. Staff explained that the DDO was introduced in 2001 and several countries with strong performance had chosen to use DDOs as precautionary measures to signal the availability of rapidly disbursing funds to markets. The changed environment and increased demand for IBRD loans raised a question about pricing of undisbursed DDOs, and a review of the contractual lending spread component was conducted on a yearly basis. The Letter of Development Policy provided the basis of the Bank's support irrespective of when the borrower chose to draw on the funds. Uruguay told Bank staff in December 2008 that it would likely request disbursement of the full amount of the loan soon after Board approval of the loan.

16. Staff stated that the decision about the timing and type of instrument to be used in Uruguay was the result of a very considered discussion with the authorities. All agreed that the most important thing was to preserve all the social improvements that had happened in the country to forestall any possible deterioration in economic conditions. This DPL included areas of reforms that had proven important in both the long and short term, as well as important measures to improve the efficiency and equity of the tax system. Work was continuing to reduce vulnerability in Uruguay's capital markets. Staff believed that all these measures would have a large development impact and the operation was an appropriate response to current circumstances.

17. **CAS Envelope.** Given that the proposed DPL absorbed more of Uruguay's CAS envelope than initially envisaged, several speakers wondered how the shift away from investment lending affected the country's development agenda. To stay within the CAS envelope, the country would need to drop some important infrastructure investments, and speakers asked about the long term opportunity cost of the operation. Some other speakers noted that despite the larger than anticipated size of the DPL, the operation remained within the country envelope, taking into account the \$60 million increase granted in the CAS progress report. While the decisions surrounding this DPL represented an appropriate response to the current circumstances in Uruguay, they strongly believed that the Bank Group should strive to place operations in the context of medium to longer-term development impacts. They urged that the postponed investment lending operations be picked up in the first years of the forthcoming CPS.

18. Staff said that the government had decided to use available CAS resources to "lean into" the global crisis rather than focus on ongoing investment projects as set out in the CAS Progress Report, and the Bank had agreed. A larger DPL sent a strong signal to financial markets that Uruguay was implementing sound economic policies and had the resources to meet its financing needs in 2009. Staff planned to present the next CAS in the first half of 2010 and the government was likely to agree to additional financing for ongoing investment operations. This decision, however, would take into account global economic developments. No additional DPLs would be required from the Bank in 2009, unless the impact on Uruguay of the global economic crisis was much larger than currently expected.

19. A speaker asked management how it intended to deliver further assistance in coming months in the absence of a new CAS/CPS, given that all available funding had been fully committed up to the existing country financial exposure limit. He repeated his request to management for careful definition of expected outcomes and results in line with the Bank's core mandate, and asked how it intended to increase the quality of its M&E systems.

20. Staff said that there was a well-defined system of M&E in this operation based on the framework already established with the authorities under the PRIDPL program. For the program areas, a medium-term results monitoring framework was in place through 2009 that would be expanded to include the payments system. Monitoring indicators for 2010-2011 would be agreed with the incoming government after the 2009 elections.

21. **Country Exposure Framework (CEF).** A number of speakers said that consideration of a specific project again raised wider questions about the Bank's operations during the global economic crisis, which required urgent Board discussion. One issue was the use of the Bank's instruments and related issues of pricing, costs and triggers, and another related to the Bank's lending commitments and

capacity. The speakers noted the discussions planned for the near future, and called upon management to proceed within the promised framework.

22. Some speakers commented that while this and other LAC DPL operations remained within country strategy envelopes, the increasing number, magnitude and pace of DPLs underscored the need for a more comprehensive crisis response strategy, including further discussions on the CEF and the methodology for reallocations. While the recent oral briefing on crisis management and response was an important first step, they asked for further clarification of the CEF and the implications of the rolling six-year approach in terms of operational planning at the country level, as well as a briefing on the use of supplemental DPLs. One speaker thanked management for additional information regarding the CEF in its introductory statement, but said that as the Bank considered its crisis response and possibly scaling up beyond CAS envelopes, it would be helpful to understand the impact of these changes in terms of operations and planning. She noted that the framework might have different implications for different regions and countries.

23. While his chair was satisfied with the overall structure of this DPL, a speaker said his key concern was the overall Bank framework for resource allocation during this crisis. While he did not underestimate the importance of extending such loans at this critical time, he was concerned about the medium-to-long term impact on achieving the development objectives the Bank had set for itself. He questioned the timeliness of the planned discussions, given that much money had already been allocated. Another speaker said that there might be issues related to reallocation of unused capital, particularly if there were vulnerable countries that had yet to realize the scope of the crisis they were facing.

24. **World Bank Mandate and LAC Response to the Crisis.** A speaker strongly believed it was part of the Bank's mandate to support countries facing problems financing development programs. By refusing support, not only would the Bank be not fulfilling its mandate, but it would lose investments that it had been making related to long-term sustainable development. The decision whether to provide support was not a moral one, but rather one of mandate. He noted that the IMF had the mandate to promote countercyclical financing when there was a specific balance of payments problem. In response to other speakers, he emphasized the need to act now, commenting that responding after a country fell into crisis would be more difficult. Many countries did not have the luxury of printing money to finance needs like some developed countries, and needed to rely on the World Bank. Another speaker welcomed staff's introductory remarks, and agreed that LAC countries were not at the center of the current crisis. Rather, the reforms and policies followed by LAC over the past decade were having results, and frequent requests for operations from the Bank could be a result of countries' institutional maturity and preparedness to implement counter-cyclical policies.

25. Following on from the Chief Economist's presentation, one speaker asked for more information on the scope and origins of the financing difficulties that affected countries were facing, and about problems accessing markets. His authorities were looking at the use, pricing and coverage of different instruments, not because they thought the Bank should not be involved, but rather to examine the effect on policies and instruments. He noted that the IMF had also developed some precautionary tools, and like the Bank, was entering the field of contingency financing. Further work was still needed on the delineation between the two institutions' roles, and on the development effectiveness of Bank contingency financing. Another speaker did not question the moral basis for the proposed operation. However, when he looked at the projects postponed to bring this loan under the CAS envelope, it raised questions whether this was the right response for long-term development. While he agreed it was important to use instruments to get ahead of the crisis, it was also important to do this in the context of the Bank's crisis response, and he hoped that the paper promised to the Audit Committee could be provided within days rather than months.

26. A speaker could see clear signals that LAC countries were not decoupled from global developments, and were suffering from commodity price movements, reduced tourism and falling remittances. While LAC countries were reacting in an intelligent way, it was not possible to tell if their

responses would work given uncertainty about future global financial developments and about availability of resources to meet future demands.

27. The Chief Economist for LAC commented on the strong impact on Latin America of falling commodity prices and financial market developments following the Lehman Brothers' failure. As rich countries tried to stabilize their finances or engineer financial stimulus packages, this was draining resources available to the developing world. Furthermore, the guarantees rich countries were providing to protect their asset prices and financial structures were ringfencing certain assets, making government guaranteed high-grade assets from the US more attractive than Latin American assets. Given the high degree of risk aversion, this left Latin American and other developing countries with local markets as a source of financing. Government demand in these markets could further displace the private sector, aggravating the real economy's problems. Given these financing difficulties, he welcomed news in December and January that Brazil, Colombia and Mexico were able to place some bonds in international markets. The Bank had looked into whether this was a sign of renewed access to international markets, but found rather that this had been a small window of opportunity accessed by dedicated funds committed to emerging markets.

28. **Future World Bank Resources.** One speaker expressed concern about using all available "bullets" now in response to the crisis. For Uruguay, the proposed approach did not address the medium to longer-term perspective, and once in place there would be no additional assistance for the next 12 months until completion of a CPS. Other LAC countries were in a similar situation. He asked how the Bank was positioned to respond to additional requests to preserve social safety nets if a more pessimistic scenario developed.

29. The VP for LAC said that the lesson learned in Latin America was that if a country went into crisis, the longer-run impact on poverty and growth was much worse. For this reason, LAC finance ministers had been proactive over the last 5-6 years in adopting the Washington consensus, and many of their policies had left them better prepared to face the crisis with better-regulated financial systems and budget surpluses. Countries knew they were facing hard times and were using DPLs and fiscal space to support fiscal stimuli and to maintain critical programs. While there was a tradeoff with development projects, experience in Asia and Latin America showed that when countries went into crisis, there was no financing for development projects. Development projects also took a year to a year and a half to implement, so were not the tool sought by finance ministers. The VP emphasized that this operation did include a large component for social safety nets.

30. The Chief Economist for LAC agreed with the first speaker that the issue of mandate clearly induced the World Bank to think about long-term development issues. Before the crisis, the main constraints to development related to policies, institutions and governance, but now the real binding constraint was financing, and he believed that the Bank's mandate was to play a countercyclical role to relax that impediment to development. The complicated issue of what to do if resources ran out was one shareholders would face if it arose.

31. **Tax Measures.** A speaker shared the view that improving the efficiency and equity of the tax system while maintaining government revenues at a level to meet the overall balance target was necessary for macroeconomic stability. He asked staff how the Bank would help to minimize the administrative and indirect costs of taxation within the proposed tax reform.

32. Staff said that tax reform was designed to be broadly revenue neutral. Tax costs had not increased as a result of reforms and the 2008 PSIA showed that reforms had had a positive impact on equity.

33. **Business Environment.** A speaker agreed that developing the business climate and capital markets could increase investment, growth and employment. He asked why the new Capital Markets Law opted for a regulatory approach versus a self-regulated approach. Another speaker believed that capital market reforms were not progressing as well as they could. He suggested refocusing efforts to tap capital from the domestic market, given Uruguay's relatively high domestic savings (16% of GDP).

34. Staff said that the reform aimed to balance the need to ensure market confidence, improve regulatory quality and manage systemic risk versus the need to stimulate capital market development. Staff believed that measures being implemented were steps in the right direction.
35. **Dollarization.** A speaker noted that Uruguay's 2002 financial sector crisis stemmed partly from the high level of dollarization, and he cautioned about the tendency towards dollarization as the current global crisis deepened.
36. Staff said that dollarization and the high level of public sector debt denominated in foreign currency represented substantial medium-term risks. However, the move from domestic currency into US dollar deposits had been small, and pressure on the peso had fallen due to the January 2.25 percentage point hike in the monetary policy reference point.
37. **Social Protection System.** Some speakers asked if mechanisms to improve the social protection system were adequate to respond to possible additional social pressures from the current crisis. Another speaker called for greater coordination between human capital development, labor policy and poverty reduction programs. Speakers commented that the PRIDPL II would help Uruguay to preserve recent social and poverty gains. They especially valued the social component of the program (Plan de Equidad Social) which aimed to reinforce the protection of the poor and vulnerable through a permanent social safety net.
38. Staff discussed efforts to reform social protection and improve the delivery and monitoring of social services, carried out with Bank assistance. While Uruguay had made substantial progress, a significant proportion of the population remained outside the social protection umbrella. During the 2002 crisis, the government proved its ability to quickly implement new programs, and Bank experts were well-placed to provide additional support at this time.
39. **Agriculture.** A speaker noted the country's reliance on agriculture, which could be affected should commodity prices fall, and he encouraged diversification to mitigate this risk.
40. Staff said that Uruguay had moved to diversify its exports and increase value-added in the economy, including policies to enhance productivity and promote new productive sectors.
41. **Information Transparency Framework.** A speaker noted that significant progress had been made in improving the information transparency framework, especially accounting standards. He asked to what extent the new entity in charge of accounting standards was independent from the Ministry of Economy and Finance (MEF). Another speaker asked for additional information on the bankruptcy law trigger and its related action plan.
42. Staff said that the new entity in charge of accounting standards under the MEF was operationally independent on a day-to-day basis, but its performance was overseen by the MEF on an annual basis. Bankruptcy reforms had been effective since November 2008, although implementation was in its early stages. A Bank team planned to visit in March/April to assess progress and to identify critical areas of support to be provided under the Institutions Building Technical Assistance Loan provided by the Bank.
43. **Coordination with MDBs.** Some speakers were pleased to see coordination with the IDB in several critical sectors. Continued close coordination, including with the IMF, was essential in the current global economic environment. Some speakers noted that this operation was supported by extensive analytical work and an institution-building technical assistance loan prepared in close collaboration with the IDB. Another speaker asked for more information about loans received from the IDB and the CAF.
44. Staff said that the CAF approved a credit line of \$400 million in July 2008 for general budget support to assist the debt management strategy. The first important component of the IDB lending program was a conditional credit line of US\$200 million to finance multi-sector projects to increase safety nets for poor children and teenagers. A second component was a conditional credit line of US\$300 million approved in November 2008 to provide residents of informal settlements in Montevideo access to adequate infrastructure and services. IBRD and IDB staff met frequently to coordinate lending programs.

45. **Concluding Remarks of the Speaker Representing Uruguay.** The speaker expressed his authorities' gratitude to the Board for its support of this DPL for Uruguay. He also thanked World Bank staff members for their partnership and commitment to the goals of this DPL.

46. **Chairman's Concluding Remarks.** The Chairman pointed to his introductory remarks and added that management had the same questions as Executive Directors about future directions for the Bank. It was currently facing specific demands requesting resources, and during meetings he had conducted with governments during recent travel, countries had expressed little interest in small operations. Management needed to be aware of the demand-driven component, but also conscious of very large upcoming operations for Indonesia, South Africa and perhaps India, and to respond to these with the same level of interest shown to other regions. Management was conscious of the flexibility needed right now and believed that making some \$100 billion available over the next two years was doable. The Chairman did not envisage reaching out to shareholders in the near future. Past experience showed between 25-40 percent of IBRD lending going to LAC Region, so no regional preference was being shown with recent operations. He believed that the process put in place to deal with requests was fair, technically sound and flexible, and he looked forward to upcoming meetings on this issue.

