Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 21-Apr-2023 | Report No: PIDA35368

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Uruguay	P179367	Uruguay Green and Resilient Growth DPL (P179367)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
LATIN AMERICA AND CARIBBEAN	13-Jun-2023	Environment, Natural Resources & the Blue Economy	Development Policy Financing
Borrower(s)	**Implementing Agency**		
Ministry of Economics and Finance	Ministry of Economics and Finance		

Proposed Development Objective(s)

The Program Development Objective is to promote i) greening of the economy, and ii) stronger and more resilient growth.

Financing (in US$, Millions)

SUMMARY

Total Financing	350.00

DETAILS

Total World Bank Group Financing	350.00
World Bank Lending	350.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. Uruguay's longest economic growth spell was showing signs of exhaustion when the 2020 global recession hit, a reflection of the country's vulnerability to external shocks and domestic structural constraints. Between 2002 and 2019, Uruguay's gross domestic product (GDP) per capita increased by 153 percent (real purchasing power parity (PPP)) only behind Panama and Peru in the region. Reforms implemented after the 2002 crisis to improve the macroeconomic policy framework, sound debt management, and reduced exposure to neighboring economies contributed to this robust performance, helping increase resilience. By the end of the period, however, economic growth decelerated significantly, from 5.1 percent on average between 2003 and 2014 to 0.9 percent between 2015 and 2019, due to unfavorable conditions such as lower commodity prices, a series of adverse climate events and severe recessions in Argentina and Brazil and limited progress in creating the conditions for a more competitive, integrated and resilient economy.

2. The COVID-19 pandemic had a significant impact on the people and the economy, adding to the challenges. Tourism and other service sectors sensitive to social distancing were impacted significantly, while unfavorable weather conditions affected agricultural exports. The combined impacts led to a 6.3 percent fall of GDP in 2020. The country's pre-existing wide social safety net was reinforced with emergency measures to target the poor and vulnerable, as well as to help firms survive the shock. However, poverty incidence increased from 8.8 in 2019 to 11.6 percent in 2020, meaning around 100,000 people fell below the poverty line. The country implemented a rapid and comprehensive vaccination campaign early in 2021, one of the most successful in the world, contributing to a rebound in economic activity. GDP expanded 5.3 percent in 2021, and the recovery continued into 2022.

3. Uruguay's macroeconomic policy framework is deemed adequate for this operation. Uruguay's fiscal position is expected to continue to improve as temporary support measures are unwound, underpinned by a pledge to fiscal prudence and an enhanced fiscal framework, ratified in a referendum to the *Ley de Urgente Consideración* or LUC (or Urgent Reform Bill, a programmatic omnibus law) in March 2022. The BCU has consistently shown a strong commitment to rein inflation, including by strengthening its monetary policy framework, which enables it to keep inflationary pressures from the international commodity price spike contained. External imbalances are low and financed by foreign direct investment. An established flexible exchange rate regime and sizeable international reserves are relevant lines of defense against external shocks. In addition, public debt management is sound, and the debt trajectory is sustainable and relatively robust to standard shocks. The financial sector is sound. In addition, Uruguay's solid social compact limits policy response uncertainty and provides a strong backbone to channel conflicts effectively.

Relationship to CPF

4. The proposed operation is fully aligned with the recently approved FY23-FY26 Country Partnership Framework, and the World Bank GRID and GCRF frameworks. This operation supports CPF's Higher Level Outcomes (HLO) 1 of Increased Low Carbon Growth and Resilience to Climate Change, under which its objective 1 focuses on "Greening of the Economy", supported through Pillar 1 of this DPL with several actions including the updated of Uruguay's climate commitments as a basis and roadmap for green growth, while the native forests and marine protected areas actions protect the terrestrial and marine natural resources to retain blue and green carbon, soil nutrients, and avoid runoff to protect drinking water supplies, surface, and groundwater quality. HLO-2 on "More and Better Job Opportunities" which seeks the creation of inclusive markets under its objective 4 is integrated into Pillar 2 on resilience and inclusion through the actions on trade and competitiveness ensuring greater market access and diversified exports (including green certified exports). Furthermore, this operation's policy actions are aligned with the GRID approach and the four pillars of the GCRF in the following (non-exclusive) way: prior actions (PAs) 4 and 6 are aligned with the GCRF's pillar 1 "Responding to Food Insecurity"; PAs 9 aligns with pillar 2 " Protecting People and Preserving Jobs'; PAs 2, 3, and 8 align with pillar 3 "Strengthening Resilience", and PAs 1, 5 and 7 align with pillar 4 "Strengthening Policies, Institutions and Investments for Rebuilding Better".

C. Proposed Development Objective(s)

5. The proposed standalone DPL supports the government's forward-looking program advancing ESG oriented policies for sustainable economic growth and resilience. The Project Development Objective is to promote i) greening of the economy, and ii) stronger and more resilient growth. These policy reforms follow Uruguay's vision for sustainable, inclusive economic growth and development in the face of climate and other global challenges and shocks, including the lessons learned from the COVID-19 pandemic, recent recurrent droughts, and global instability linked to international crises and conflict. The policies supported by the operation seek to follow a green-growth paradigm that generates high quality goods and services for global markets while protecting natural resources, with greater inclusion of women and underserved populations. It also seeks to generate resilience of public and private systems and services, to ensure that the economic growth is supported by a safety net that minimizes social and environmental impacts, facilitating access to goods and services under changing conditions.

Key Results

6. The overall result will be to support Uruguay's green and resilient growth by promoting (i) the greening of the economy, and (ii) stronger and more resilient growth. Key results under Pillar 1 include the update of the Nationally Determined Contributions (NDCs) to the United Nations Framework for (UNFCCC), promotion of native forest conservation, creation of marine protected areas (MPAs), increase certified organic production, and promotion of innovation on the green hydrogen production. Pillar 2 targets results that include enhanced trade and diversification of export markets (including green certified exports), market competition and a more robust financial system, and rural women's improved access to credit.

D. Project Description

7. The proposed Uruguay Green and Resilient Growth Development Policy Loan (DPL) with Draw Down Option (DDO) in the amount of $350 million and a proposed innovative grant from the IBRD Fund for Innovative Global Public Goods (GPG) Solutions, is a standalone operation that seeks to promote i) greening the economy, and ii) stronger and more resilient growth. The government is committed to promoting economic growth and mainstreaming environmental, social, and governance (ESG) principles during its current tenure. The two pillars of this operation support these efforts by endorsing measures that mitigate greenhouse gas emissions and promote biodiversity, which contribute to global public goods and underpin the country's brand on climate stewardship, increasingly important for its integration into the global economy. This operation also promotes structural measures that advance competitiveness and resilience in the face of negative shocks, a critical contribution coming out of the COVID-19 pandemic, which followed years of sluggish growth and stagnating productivity due to long-standing growth bottlenecks.

8. The operation will include a proposed performance-based grant from the IBRD Fund for Innovative GPG Solutions (GPG Fund) in recognition of the provision of GPGs in the form of greenhouse gas mitigation and globally important biodiversity conservation that the government has been advancing through the policy reforms supported by this DPL. This grant will be approved by the Board of Directors as part of this DPF-DDO loan package and will be provided through an innovative mechanism that will allow the performance-based reduction of interest payments on the DPL. Through its leadership on the Development Committee, the Government of Uruguay has been a strong supporter of the GPG Fund objectives and has made substantial efforts to advance innovative instruments to incentivize the provision of GPGs.

9. Pillar 1 seeks to promote the greening of the economy through policy actions that generate global public goods (GPGs). These GPGs include blue carbon and conservation of biodiversity through the expansion of marine protected areas, green carbon and globally important biodiversity through protection of native forests and grasslands through tax incentives, as well as the promotion of agro-ecology and organic agriculture which will increase the potential of Uruguay's products to reach new and premium niche markets, that are already showing success for exports of organic beef[1], while increasing the sector's resilience to climate change. Protecting and improving management of the marine and land/soil resource base of the country is also critical to ensure long-term economic growth by sustaining fisheries and reducing soil runoff to maintain crop productivity and reduce surface water pollution. Such pollution causes algae growth that has closed beaches for tourism, while also impacting coastal fisheries and potable water sources. This pillar also advances production of renewable energy.

10. Pillar 2 helps to promote stronger and more resilient growth through actions that enhance competitiveness, economic diversification, and development. The growth slowdown heading into the COVID-19 pandemic along with climate related incidents that include droughts in the productive areas of the country have stressed the importance of a stronger and more diversified economy to better cope with shocks. The measures included under this pillar support (i) a more competitive environment, through a strengthened competition framework, (ii) easier access to imported food through reduction in tariffs and trade facilitation measures that diversify the input and goods markets that Uruguay depends on, promoting competitiveness and decreasing risks from relying on fewer providers, (iii) a deeper financial sector to effectively promote and intermediate savings in domestic currency and help smooth shocks, and (iv) increasing direct access to credit by rural women.

E. Implementation

Institutional and Implementation Arrangements

11. The MEF will be the agency responsible for the overall monitoring, evaluation, and results framework. MEF will also coordinate with the relevant ministries and agencies of this operation monitoring and evaluation. The agencies responsible for the implementation of the prior actions listed in this operation include, for pillar 1: (i) Ministry of Environment, (ii) MIEM, and the MGAP. Pillar 2 agencies include: (i) BCU, (ii) MGAP, (iii) MEF, and (iii) CPDC. The capacity for monitoring, evaluation, and accountability is considered good given the strong governance ranking of the public sector institutions in Uruguay. The World Bank will also regularly monitor the implementation of the program through supervision missions and work with MEF to follow the program.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

12. The policy measures supported by this DPF series are expected to play a role in strengthening Uruguay's institutions and environmental management to promote greening the economy and stronger and more resilient growth. As such, the overall reform package supported is expected to contribute to enhancing the possibilities of sustainable growth and

[1] https://www.inac.uy/innovaportal/v/9894/14/innova.front/programa-de-carne-natural-certificada-del-uruguay---pcncu

improved capacities of the government to respond to future shocks, that, in general, affect disproportionally the most vulnerable groups of the society.

Environmental, Forests, and Other Natural Resource Aspects

13. The Prior Actions (PA) supported through the Uruguay DPL-DDO are likely, in aggregate, to have a positive impact on Uruguay's environment, forests, or other natural resources. Actions under policy areas supported by the operation are either positive or neutral in their potential environmental effects and no significant impacts are expected from the policy actions. Furthermore, the national legal framework incorporates the necessary mitigation measures for adequate management of any minor potential effects.

14. Pillar 1: Greening the Economy. This pillar deals largely with promoting conservation and investment in a lower-carbon energy matrix. The Prior Actions under this pillar are expected to lead to positive environmental impacts when considering Uruguay's environmental management system, strong oversight and enforcement capacity, and robust environmental regulatory framework, which are adequate to mitigate any potential adverse impacts that could result from eventual extension of agroecological production (PA4). Prior Action 1 deals with raising Uruguayan climate commitment to foster conservation and reducing GHG emission through the submission of an updated NDC to the UNFCCC. Activities under this pilar are expected to foster conservation and biodiversity protection by establishing economic incentives to native forest registration (PA2), increase protected marine areas (PA3), contributing to positive outcomes for Uruguay's environment while also supporting the provision of global public goods. In addition, activities under this pillar aim to promote innovation by creating a fund to promote research in clean energy (PA5).

15. Pillar 2: Stronger and more Resilient Growth. Overall, the prior actions supported by this pillar are not expected to have significant negative effects on the environment, forests, and other natural resources. The pillar will support policies aimed at: (i) promoting trade and competition (PA 6 and 7); (ii) promoting capital markets development, (PA8); and (iii) expand financial opportunities for rural women (PA9). There could be indirect negative environmental impacts from emissions generated from the transportation and disposal of new imported trade products (PA 6). The Borrower has strong environmental legislation and institutional capacity to supervise and mitigate potential negative impacts. The Ministry of Environment is the national regulatory entity in charge of formulating, implementing, and orienting environmental, conservation and use of natural resources projects and with a robust environmental impact system to mitigate potential harm, and provide oversight and regular monitoring of environmental indicators, especially pollution. The Ministry of Environment was created in 2020, and centralizes sustainable development and climate change, as well as old competencies given to the National Directorate of the Environment (DINAMA) and to the National Water Directorate (DINAGUA). The environmental impact assessment and licensing has been a requirement since 1994 (Ley 16,466) and Uruguay is considered among the top ranked countries globally based on environmental performance[2], and on environmental regulation and enforcement.

G. Risks and Mitigation

16. The overall risk to achieving the PDO of this operation is assessed as Moderate. All risk categories have been assessed as Moderate, except for Fiduciary and Environment and Social, which have been rated as Low. The detailed ratings have improved with respect to the 2020 DPL (Uruguay COVID-19 Response and Economic Recovery) where two risk categories were assessed as substantial: Macroeconomic and Sector Strategies and Policies. With the most pressing uncertainties

[2] Ranked #6 according to the 2018 Environmental Performance Index. See: Wendling, Z. A., Emerson, J. W., Esty, D. C., Levy, M. A., de Sherbinin, A., et al. (2018). 2018 Environmental Performance Index. New Haven, CT: Yale Center for Environmental Law & Policy. https://epi.yale.edu/

from the COVID-19 pandemic having dissipated, a fiscal consolidation process underway, and sizeable public and external buffers, the Macroeconomic risk for this operation is assessed as Moderate, notwithstanding aggregate uncertainty, as the implementation of the supported measures and achievement of the results indicators is unlikely to be affected by macroeconomic developments in the near future. Risks related to Sector Strategies and Policies have also been assessed as Moderate, with the current administration over three years into its tenure and a reform program that was endorsed by a referendum.

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APPROVAL

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