Uruguay’s Path to Strong, Inclusive Growth

By Elif Ture

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Latin America has made huge progress in reducing poverty and inequality in the past fifteen years. Among the region’s countries, Uruguay stands out as one of the most inspiring examples of the efforts to encourage growth with social progress. The expansion of opportunities and improvement in social indicators achieved by Uruguay since the mid-2000s present a remarkable success story of a post-crisis economic and social recovery.

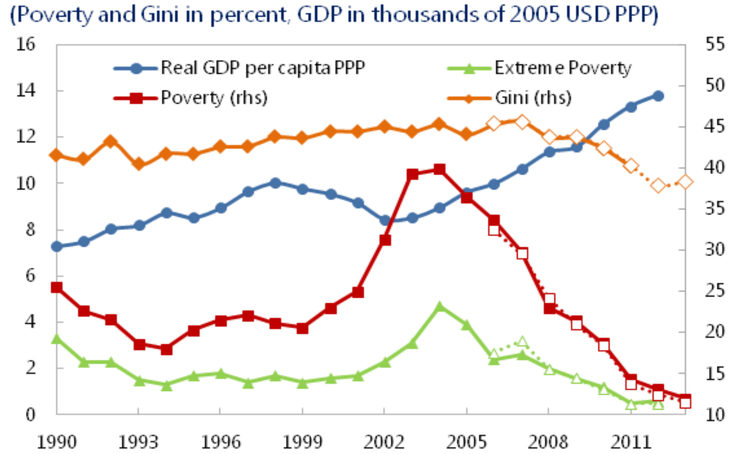
How did Uruguay manage to pull this off? Our recent report on Uruguay’s economy reviews the country’s main social achievements over the past decade and points to two factors that helped the poorest—strong growth and innovative social assistance policies. But with growth in Latin America slowing, the key challenge for Uruguay will be to keep its growth strong and social spending fiscally sustainable to ensure that these impressive gains are not reversed.

Key achievements

Inclusive growth is not a new phenomenon for Uruguay; in fact, it has long been a key policy objective. Uruguay has been home to the lowest inequality and poverty rates in the region since at least 1990. While the 1999–2002 recession and the ensuing financial crisis took a heavy toll on its social indicators, Uruguay has made remarkable progress in improving the living standards of its people thanks to strong economic growth and active social policies (Chart 1).

Chart 1. Uruguay: Poverty, Inequality and Growth /1

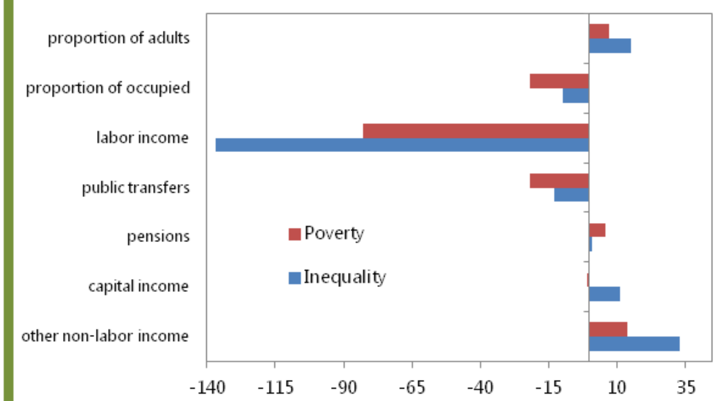
(Poverty and Gini in percent, GDP in thousands of 2005 USD PPP)



Source: National Statistics Institute (INE), and World Bank (WDI).
1/ Solid series represent data for urban areas (with more than 5000 inhabitants).
Dotted series, which begin in 2006, cover urban areas as well as rural areas.

Rising employment and labor incomes, as well as the introduction of targeted public transfers have been the main factors behind the steady fall in poverty since 2005 and inequality since 2007, which are now at their multi-decade lows (Chart 2). At the same time, an increase in the supply of high skilled workers in the last decade—due mostly to better access to higher education—and an increase in the demand for lower skilled workers during a period of strong growth in the agricultural and construction sectors have helped reduce the skill premiums, wage gaps, and income inequality.

Chart 2. Uruguay: Factors Contributing to Reduce Poverty and Income Inequality /1
(in percent)

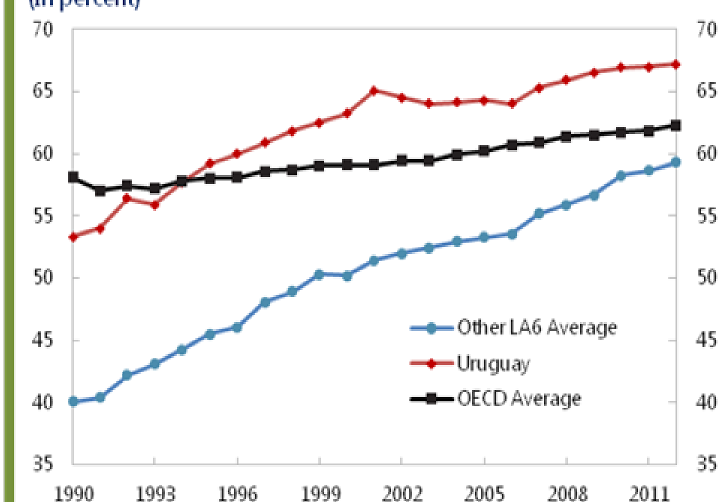


Source: Castetan, Barriga and Lugo (2013), "The evolution of poverty, inequality and income mobility in Uruguay during the 2000s", The World Bank, Washington DC.
1/ Based on the methodology introduced by Azevedo, Inchauste and Sanfelice (2012), "Decomposing the decline in Latin America", World Bank, Policy Research Working Paper No. 6715.

Yet the top income shares have remained high relative to international standards. The income share of the top 1 percent of the population was about 14 percent between 2009–11, compared with an average of 10 percent in advanced countries, even as the Gini index (a commonly used measure of income inequality) decreased gradually between 2008 and 2012.

Uruguay continues to be a frontrunner in gender equality in labor markets. Female labor force participation hovers around 5 percentage points above the countries in the Organization for Economic Cooperation and Development (OECD) and 10 percentage points above Latin America during the past decade, and reached 67 percent in 2012 (Chart 3). That said, as always, there is room for further improvement. Large differences still prevail in labor market participation rates across genders, and female employment and wages still lag those of males, although the differences remain low by international standards.

Chart 3. Female Labor Force Participation Rate
(In percent)

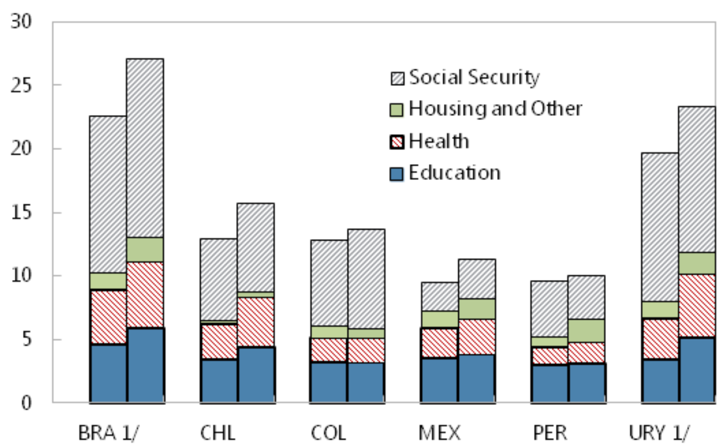


Sources: World Bank, World Development Indicators and OECD.

Far-reaching policies

Public social spending increased from 20 percent of GDP in 2005 to 25 percent in 2012, reflecting a deliberate social policy effort (Chart 4). Once the recovery from the 2002 crisis was firmly established, Uruguay created a temporary social emergency plan (PANES) between 2005 and 2007 to tackle extreme poverty through targeted cash transfers. Later in 2007, the government launched a more comprehensive and permanent Equity Plan, bringing an expansion in the coverage and amount of social assistance transfers, as well as far-reaching tax and health care reforms. Among other changes, the tax reform introduced personal income taxes and improved the progressivity of the tax system, while the health care reform, together with an extension in 2010, nearly tripled the health insurance coverage under public plans, making health insurance coverage almost universal.

Chart 4. LA6: Social Public Expenditure, 2005 and 2010
(In percent of GDP)



Source: Economic Commission for Latin America and the Caribbean (CEDLAS).
1/ For Brazil and Uruguay, the latest social expenditure data are for 2009.

The government took further steps to expand unemployment insurance and non-contributory pension benefits in 2009. They also introduced measures to promote social housing in 2011 and financial inclusion in 2014.

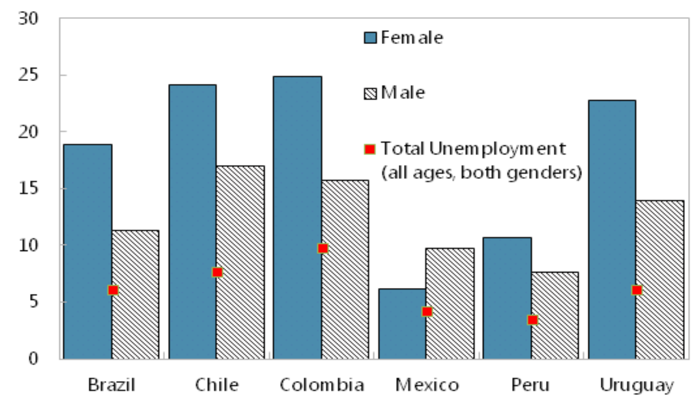
Tackling poverty and income inequality

The poverty reduction following the 2002 Uruguayan crisis was partly helped by the country's strong economic growth, which raised employment and incomes while also enabling higher spending on social policies. Therefore, maintaining strong and stable economic growth and ensuring that social spending policies are fiscally sustainable over time will be crucial for safeguarding and deepening the social gains achieved over the past decade.

Strengthening skills, especially for women and youth, would also help achieve a more durable reduction in poverty. Uruguay's cash transfer policies were successful in reducing extreme poverty over the past decade, but a sizable share of the population remains at risk of falling back into poverty. Strengthening job training opportunities and job search assistance, especially for women and youth (Chart 5), would help transfer the poor and vulnerable population into the labor market, thereby providing a more durable strategy for eliminating poverty and vulnerability.

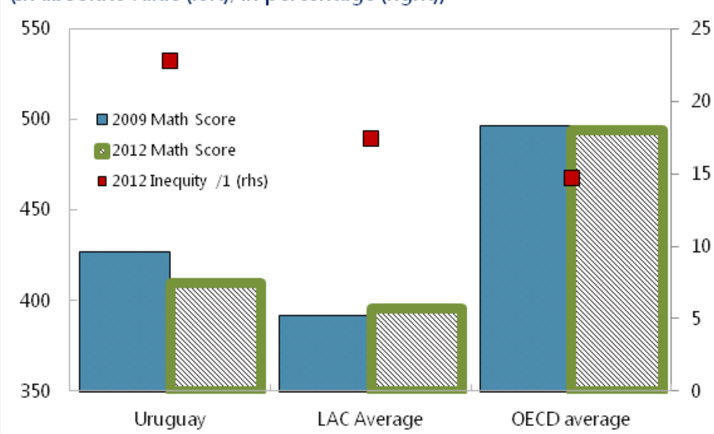
Enhancing the quality of education is the single most important challenge for improving equity as well as raising Uruguay's long-term growth potential. Declining Program for International Student Assessment (PISA) scores and the high dependence of student performance on socioeconomic conditions raise concerns about the quality and equity of education (Chart 6). Uruguay currently spends about 4.6 percent of GDP on education, below the 5.4 percent average among OECD countries. While additional resources could be allocated to improve the quality of education, these could be augmented if also reforms are undertaken to enhance the efficiency of education spending. Evidence suggests that Uruguay could save 15 percent in secondary education spending and achieve the same enrollment rates. At the same time, recent research shows that improved labor skills and education would increase per capita income projected for 2050 by 40 percent in Uruguay, creating a virtuous cycle of growth and equity.

Chart 5. LA6: Youth Unemployment for Ages 15-24, 2012 /1
(In percent of the labor force)



Source: Socio-Economic Database for Latin America and the Caribbean (CEDLAS).
1/ 2011 for Chile.

Chart 6. PISA Results, 2009 vs 2012
(In absolute value (left), in percentage (right))



Source: OECD.
1/ Percentage of variation in student performance explained by socio-economic background.

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