12 Industrial Competitiveness and Government Policies in Uruguay
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12.1 INTRODUCTION

After the oil crisis of 1973 the new military government in Uruguay abandoned the industrialisation strategy of import substitution and changed the incentive system to stimulate industrial exports. Growth rates of GDP and exports accelerated, and this revitalisation was sponsored to a large extent by the government by means of subsidised credits and tax exemptions for exporting firms (Corbo and de Melo, 1985, pp. 165–8).

After 1978, economic policy was directed at price stability, but pegging the peso to the $US without the necessary control over the monetary variables led to highly distorted prices and increasing overvaluation of the currency. Growth continued on the basis of rising imports and a huge inflow of foreign capital. At the same time, domestic industry lost its competitiveness due to the overvalued exchange rate (Corbo and de Melo, 1985, p. 160). The increase in domestic demand was not accompanied by an increase in domestic production and this ultimately led to the crisis of 1982 and the heavy burden of foreign debt. The period of crisis ended in 1985, but after two years of renewed growth, stagnation returned once again after 1987. This structural economic instability hampers economic development as it creates uncertainty and passivity among economic agents, and hinders long-term and medium-term planning and optimal investment decisions by private and public enterprises.

Apart from long-term economic instability, three main problems may be identified regarding economic development in Uruguay. First, rather than using domestic fiscal instruments, integrated industrial credit policies, or an industrial development bank, the major policy instruments used by the government were related to the external sector. Industry was stimulated by import barriers, exchange controls and differentiated exchange rates, and at the end of the 1970s the Uruguayan government tried to reach price stability by pegging the peso to the $US. But these ad hoc policies
were motivated by urgent disruptions and failed to bring about macro-economic equilibria most of the time.

Second, decisions by economic agents were for a long period made in the context of a strategy of import substitution. This strategy tended to increase the monopolisation of economic activities, and lacked stimuli to enhance efficiency. Thus, economic decisions in Uruguay were often directed towards rent-seeking and the protection of rents rather than towards efforts to increase efficiency. Such a situation continues to exist, but less markedly than in the past.

Third, a long-term development strategy was lacking, and consequently, no significant change occurred in the industrial structure after 1973. Exports increased after the policy shift of 1974, but this increase was based on the traditional industrial structure, shaped in the era of import substitution. By means of export incentives, firms were stimulated to export part of their production, but only a small fraction of manufacturing industry reached the efficiency levels required to compete in world markets (Messner, 1990, p. 54). It is characteristic of the industrial development process of Uruguay that the levels of investment were insufficient to sustain manufacturing growth in 1986 and 1987. In 1988 growth came to a halt not so much because of falling demand, but because installed capacity had reached the level of full utilisation. There is no such thing as a clearly defined sectoral growth path, and growth was often merely the result of favourable external developments (Balcarcel, 1992, p. 19).

The economic crisis at the start of the 1980s had a dramatic impact on the country’s economy. Between 1980 and 1990 GDP increased by 5 per cent in real terms, while manufacturing GDP declined by almost 10 per cent. This resulted in a diminishing of the share of gross manufacturing production in total GDP from nearly 30 per cent in 1980 to 25 per cent in 1990. A major cause of the decline of manufacturing output was the low investment ratio in the sector, both in relation to manufacturing output and in relation to total investment in Uruguay. Figure 12.1 shows investment as a share of GDP and industrial production during the 1980s.

Contrary to the development of manufacturing output, manufactured exports increased during the 1980s and the country became increasingly dependent on exports of manufactures, as shown in Figure 12.2.

The decrease of manufacturing output at a time that overall GDP increased is an indication of the inability of manufacturing industry to adjust successfully to the new economic environment of the 1980s. As such the growth of exports suggests the opposite, but these exports were produced by only a few highly specialised manufacturing sectors and firms