

**Seminar on Prospects for
Cuba's Economy
Bildner Center, CUNY, May 21, 2012**



**Cuba's Economic Problems and Prospects in a Changing
Geo-Economic Environment**

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Objectives:

- To review Cuba's current economic situation;**
- To outline and evaluate the policy approach of the Government of Raul Castro;**
- To explore implications of the changing geo-political setting for Cuba's economy;**
- To outline a number of possible future scenarios**

Main Argument:

- Current economic situation is difficult;**
- Strategic economic re-orientation:**
 - right direction; modest; slow implementation;**
- Prospects are positive, with major downside risks**
- Major economic uncertainties and risks in the near future**

Outline:

- I. Cuba's Current Economic Situation:**
- II. The Reform Approach so far:**
- III. Economic Performance, 2011-2012**
- IV. Implications of the Changing Geo-Political Context**
- V. Some Scenarios for Cuba's Economic Future**

I. Context for the Reforms of 2010-12

- 1. General economic performance during the “Special Period”, 1990-2011:
 - Human development has been positive;
 - Some success: growth and recuperation;
 - Some “**Islands of Prosperity**” (e.g. Tourism sector, Old Havana, mixed corporations

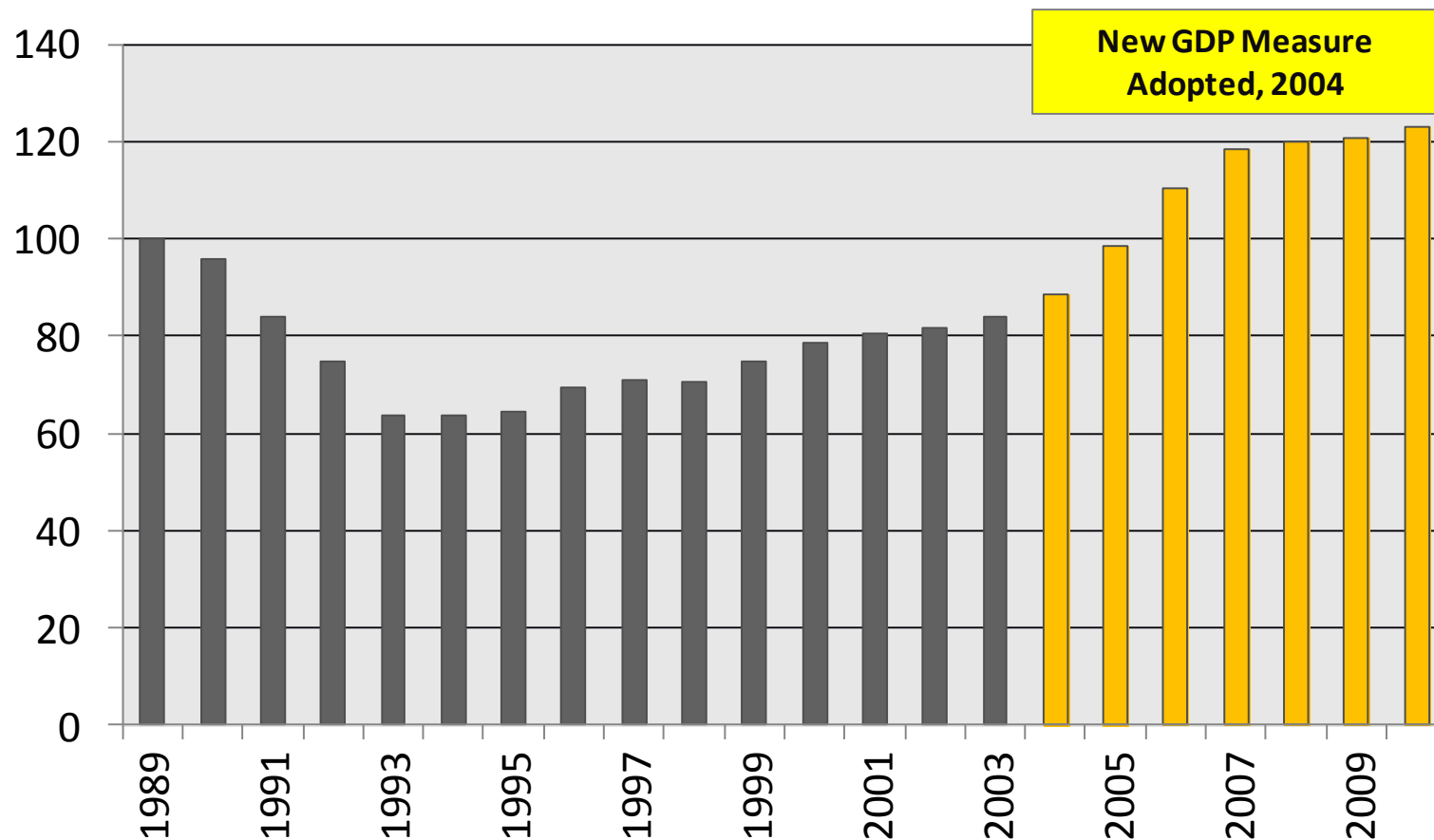
I. Context for the Reforms of 2010-12

But:

- Real Income per person has not risen in pace with economic growth;**
- Production of Goods – as opposed to services – has not improved;**
- A range of problems continues**

Chart 1 GDP per capita, 1989-2010

Base Year: 1989 = 100.



Source: ONE, AEC various issues and UN ECLAC, Preliminary Overview, various issues

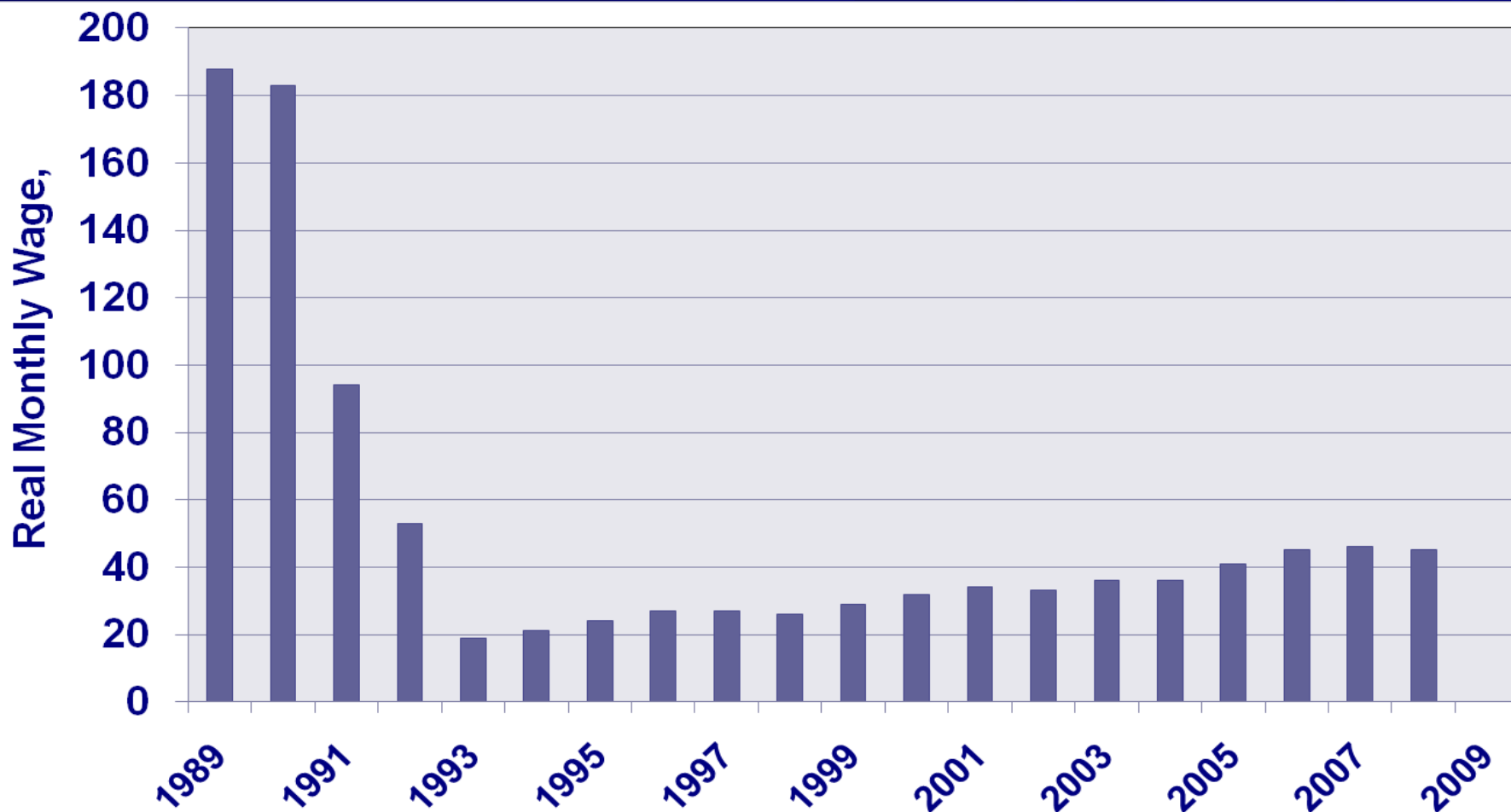
■ But: **Cuba's GDP statistics are dubious:**

- The Oficina Nacional de Estadísticas (ONE) adopted a new approach to measuring GDP (**ONE 2006, Table 2.1.2.30**).
- Increased the value of “government consumption” by **76.6 percent**—for health, mainly – thereby raising Cuba's GDP per capita and increasing its growth rate;

■ Although the Cuban economy surpassed the levels of 1990, the **real value of wages in Cuba remained at around 40 percent of the 1989** level (see Chart 2).

Actual economic performance: weak

Chart 2 Cuba: Real Inflation-Adjusted Wages, 1989-2009
(Pesos, Moneda Nacional)



Vidal Alejandro, Pavel, “*Política Monetaria y Doble Moneda*”, in Omar Everleny Perez et. al., *Miradas a la Economía Cubana*, La Habana: Editorial Caminos, 2009

- **Average formal economy wage is around 25-30% % of the 1989 level;**
- **Minimal recuperation since 1993**
- **Many have other income sources**
 - remittances;
 - self-employment
 - home produced G&S;
 - goods in kind from the state;
 - underground economy;
 - pilferage;
- **Those without other income sources:
deep poverty**

Chart 4. Cuban Exports and Imports of Foodstuffs, 1989-2010
(excluding Tobacco and Alcoholic Beverages) (Millions CUP)

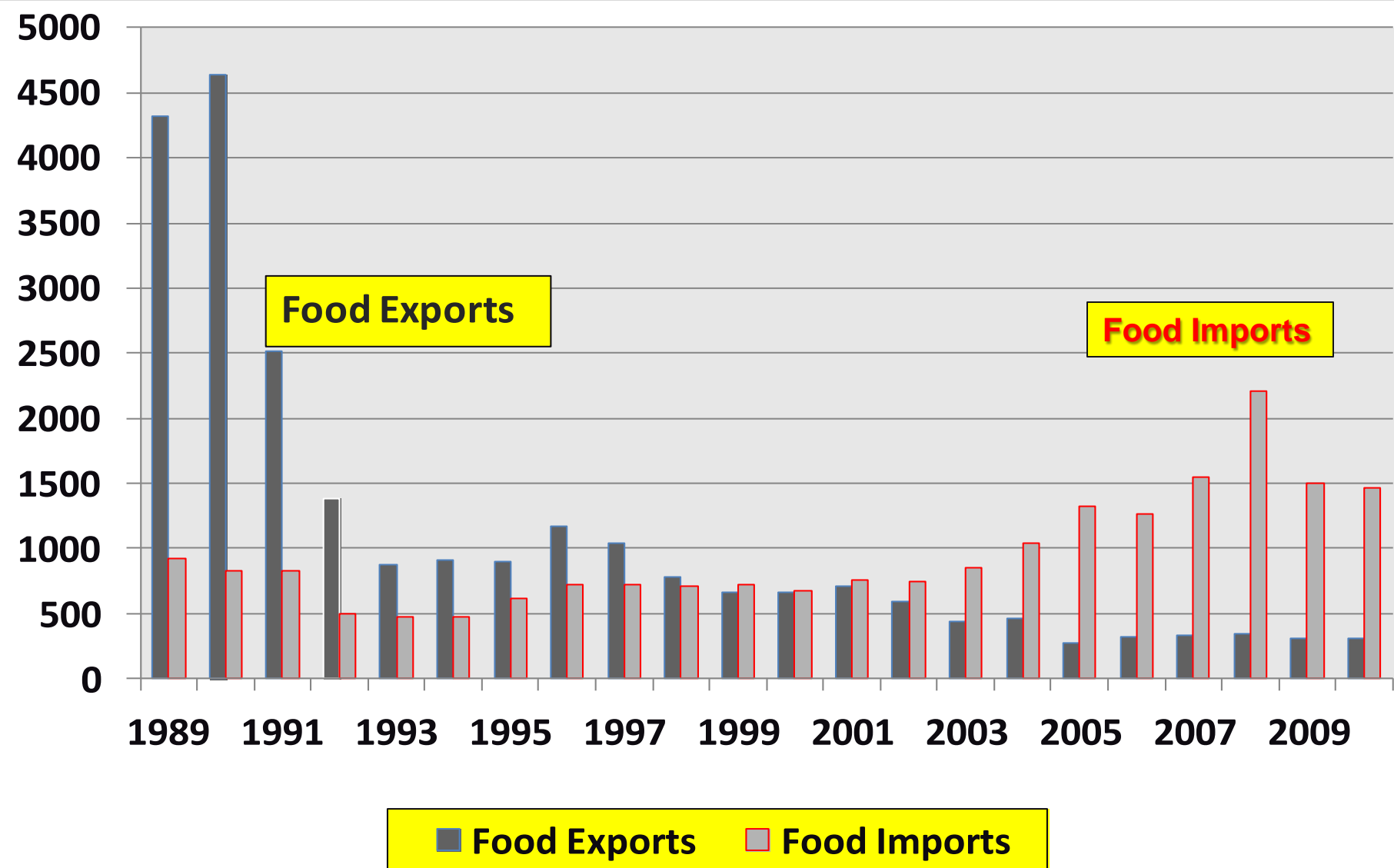
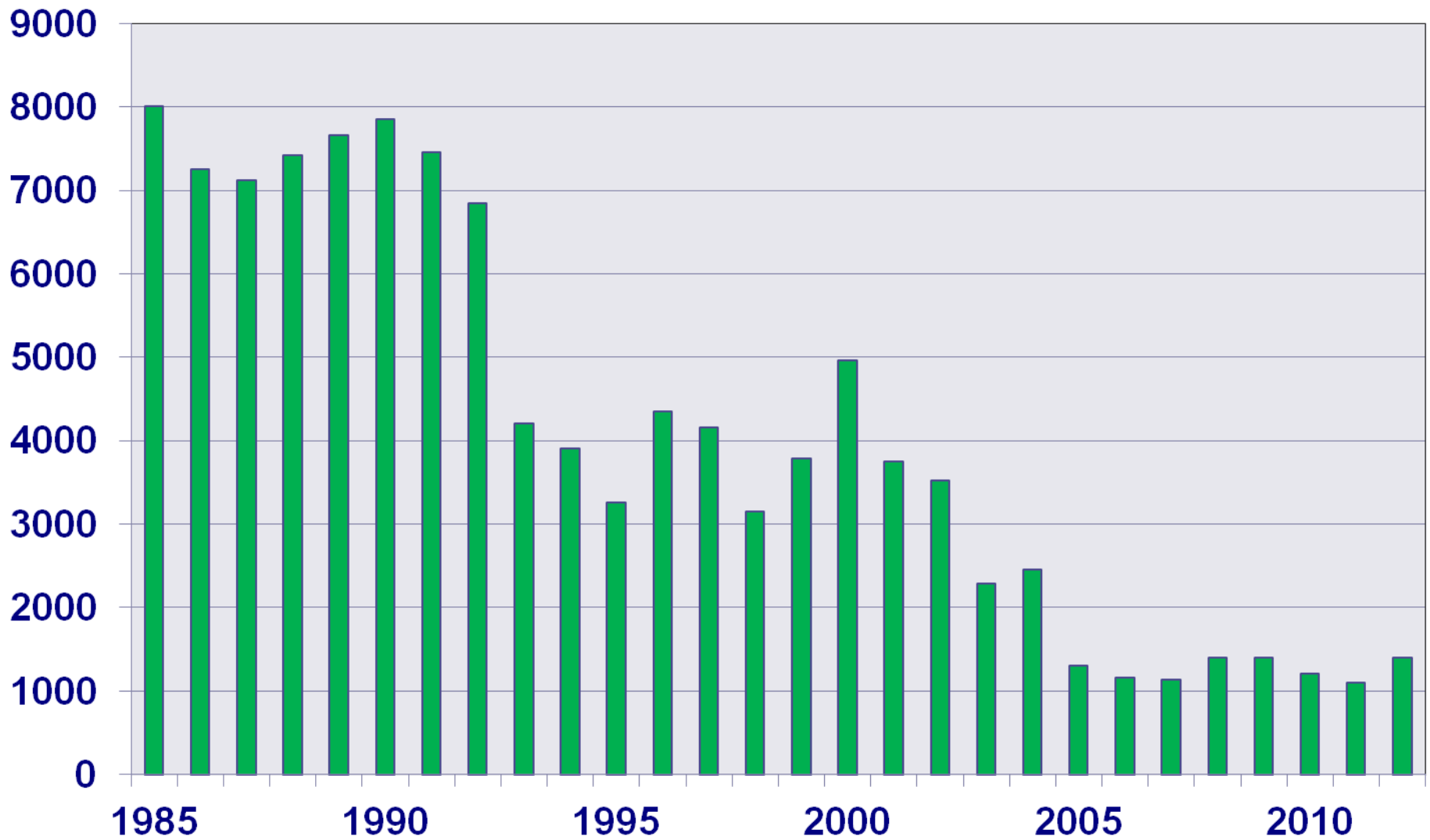


Chart 3 Cuban Sugar Production, 1985-2012
[‘Thousands of tonnes]

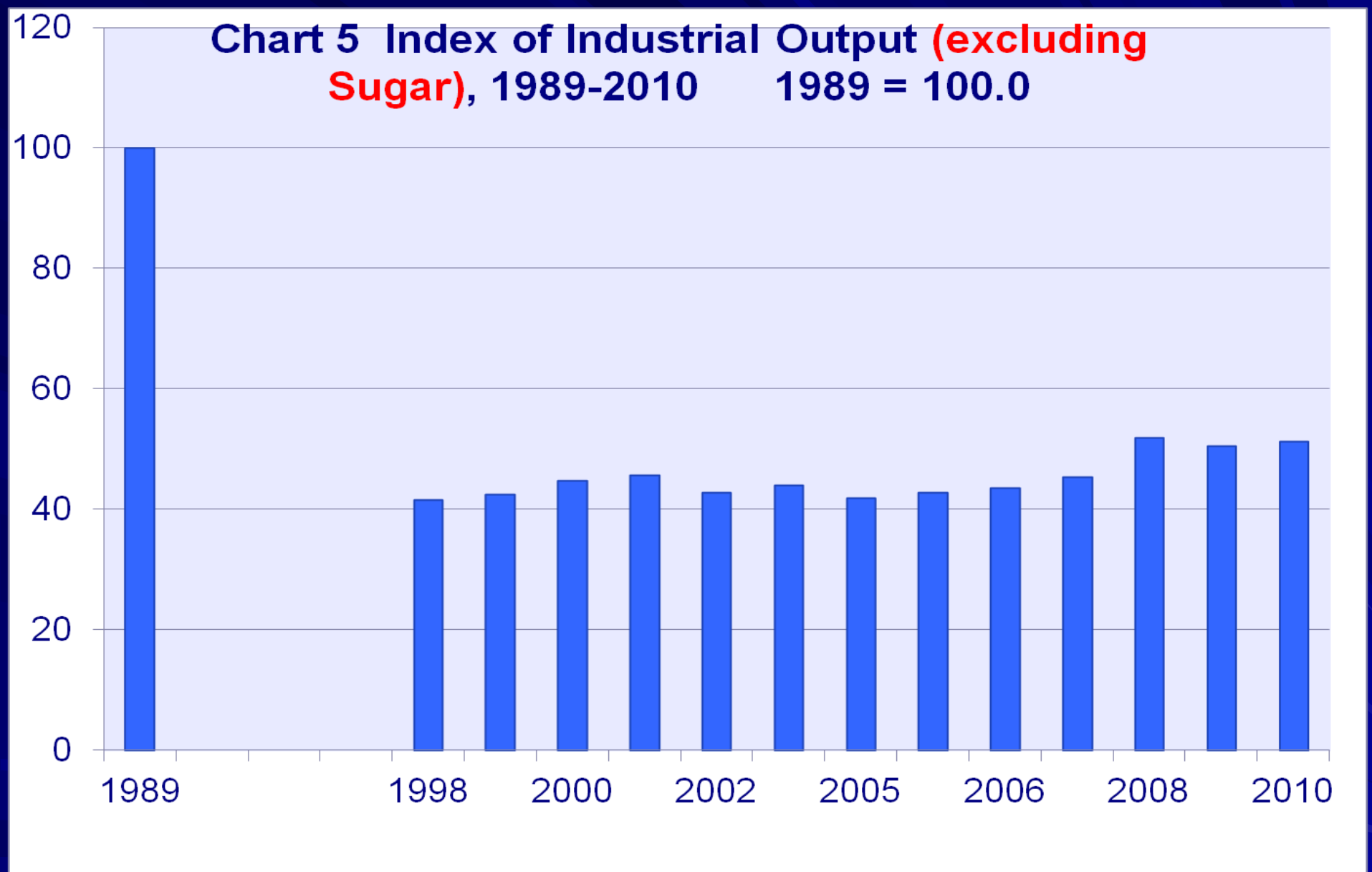


Source: NU CEPAL, 2000 Cuadro A.86; ONE, 2012 Table 11.3

■ Sugar sector collapse: major economic catastrophe

- Regional and local development impacts;
- Cluster of input-providing and output processing activities collapse;
- **32.1% increase in idle farm land** (to 1.2 million hectares);
- Reduced foreign exchange earnings
 - **+/- \$3.5 billion in 2010;**
- By-product electricity generation reduced;
- Increased unemployment;
- Ethanol production foregone

**Chart 5 Index of Industrial Output (excluding
Sugar), 1989-2010 1989 = 100.0**



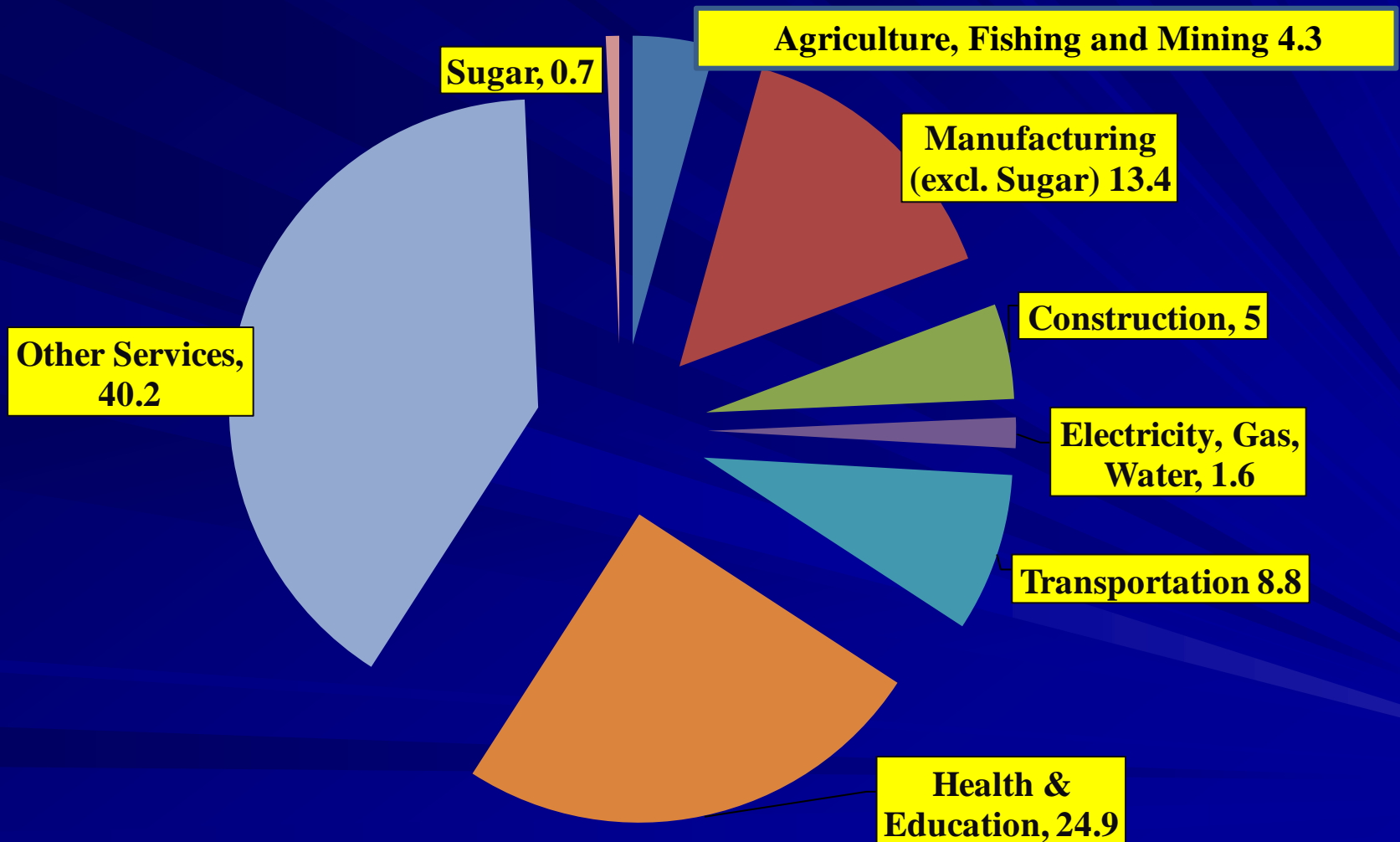
Source: ONE AEC, 2004, Table 11.1 and 2IX.1, and subsequent issues

Note: Data for 1990-1997 are not available

Causes of De-Industrialization:

- The **policy environment** (Dual monetary and exchange rate systems);
- A grossly **overvalued exchange rate**;
- The **1990-93 melt-down**;
- Technological inheritance from the **USSR**;
- Unfair competition from **China** with its grossly **undervalued exchange rate**
- **Neglect of maintenance and re-investment**

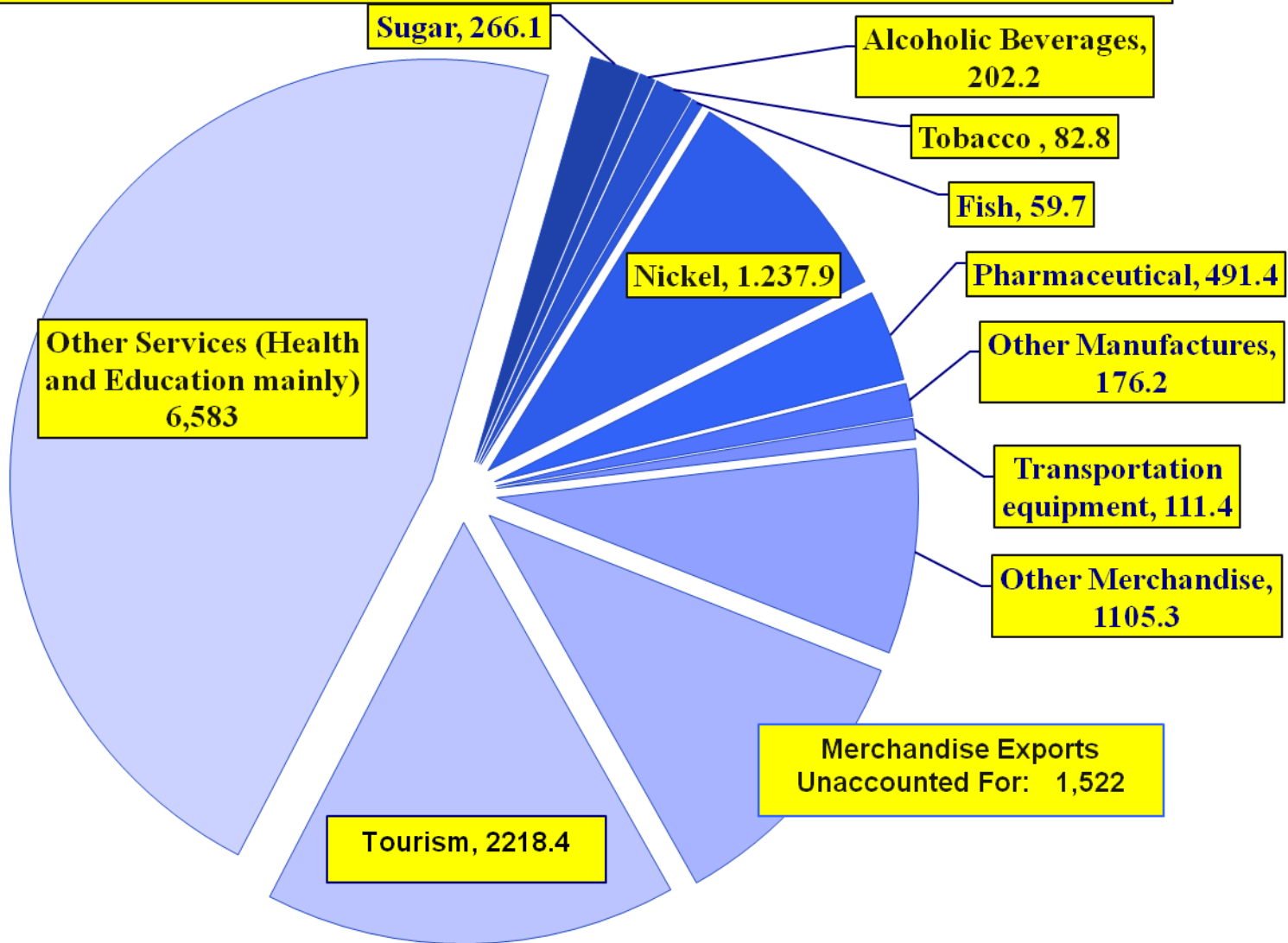
Chart 6 Structure of Production in the Cuban Economy, 2010; Percentage of Total GDP



Source: ONE, 2011 Table 5.5

Chart 7A Cuban Exports By Product Shares, 2010

Total: 13,399 Million Cuban Pesos



Source: ONE, AEC, 2010, Table 8.11, 8.2 and 5.11

Chart 8 Cuba's Merchandise Exports by Destination, 2010 (Total: \$4,597.7 million)

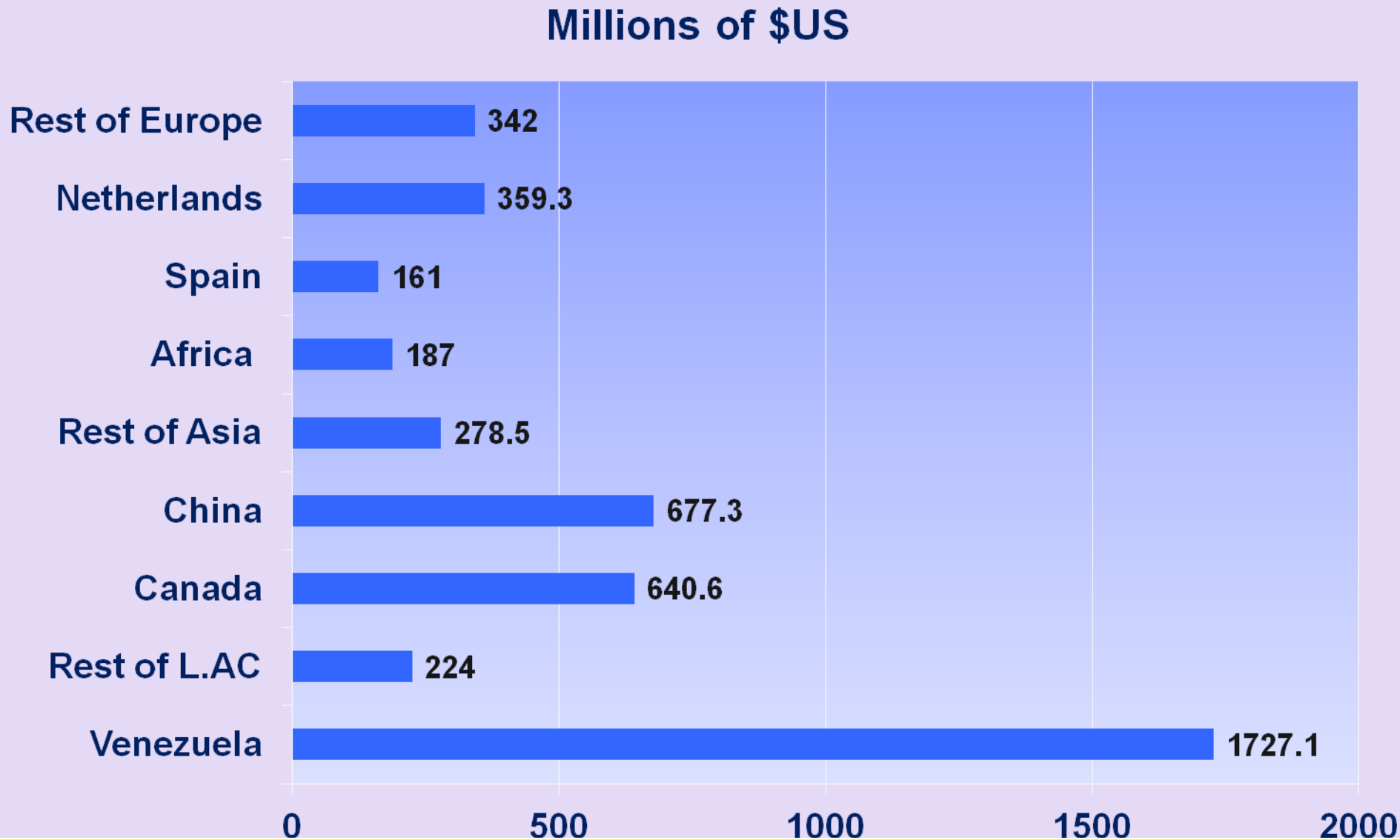
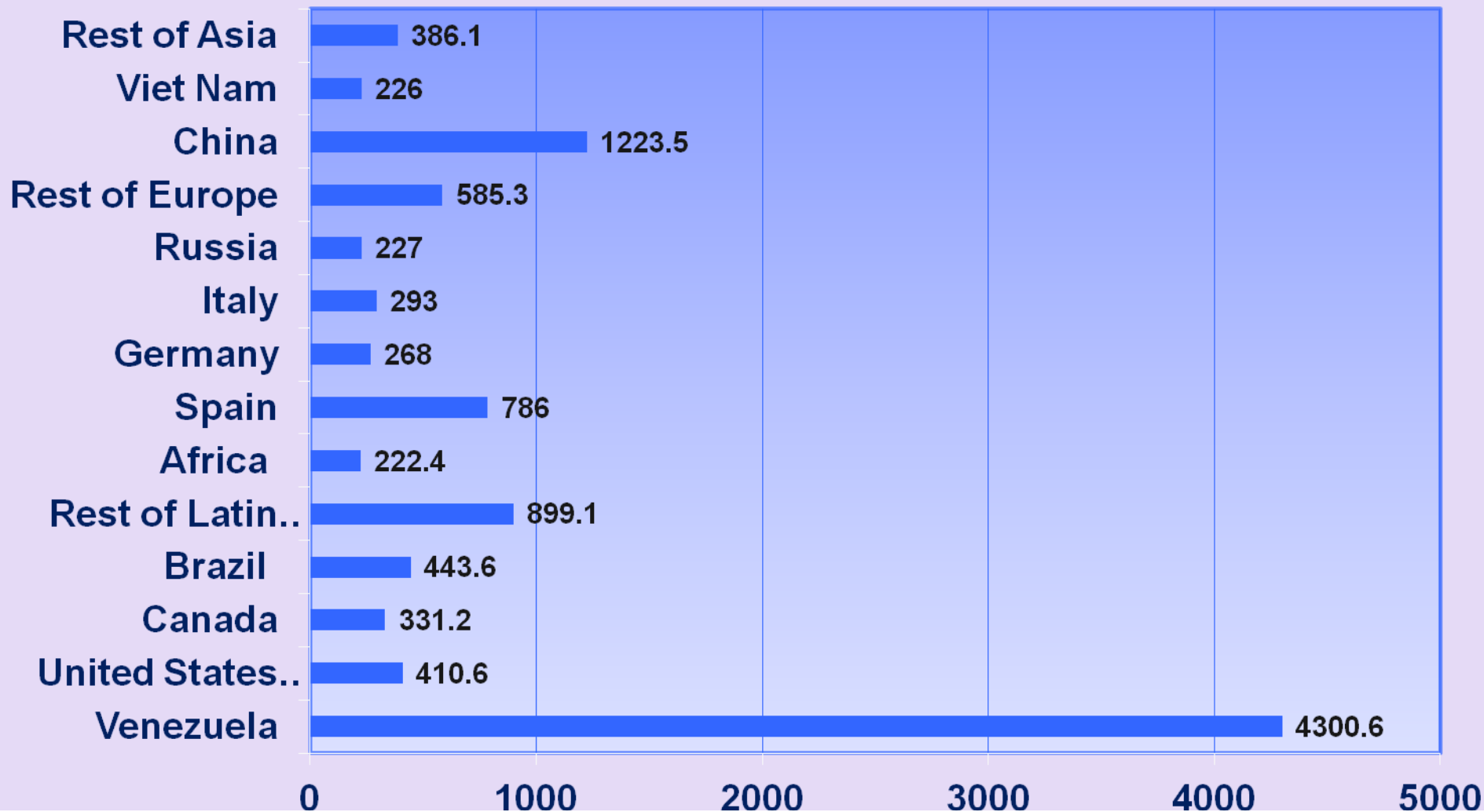


Chart 8 Cuba's Merchandise Imports by Source, 2010 (Total: \$10,646.8 million)

Millions of \$US



Insufficient Investment

- **In 2010** (ECLAC's Preliminary Overview, 2011)
 - **Cuban Investment** **8.2% of GDP**
 - **Latin America** **21.9% of GDP;**
- **Insufficient maintenance**
 - **Run-down capital stock:**
housing infrastructure, etc.

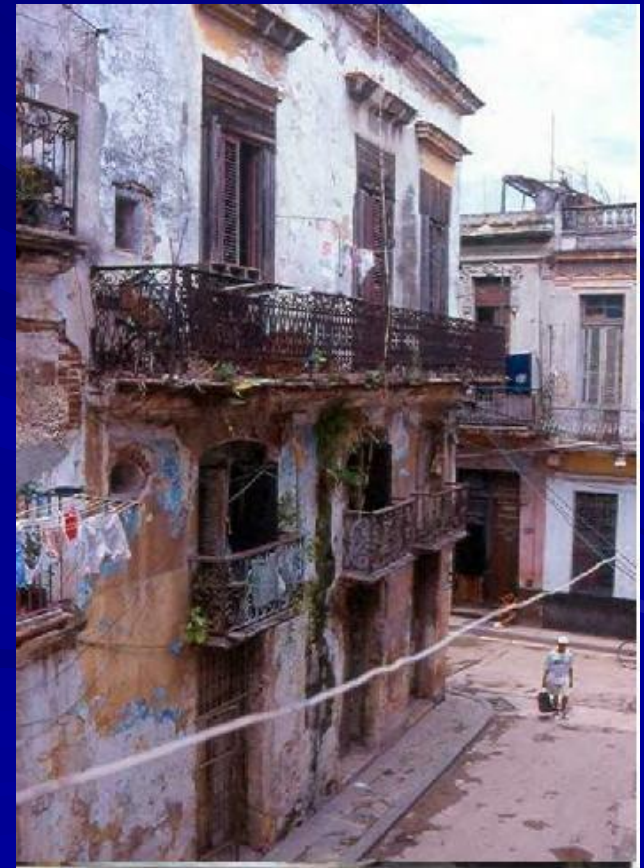
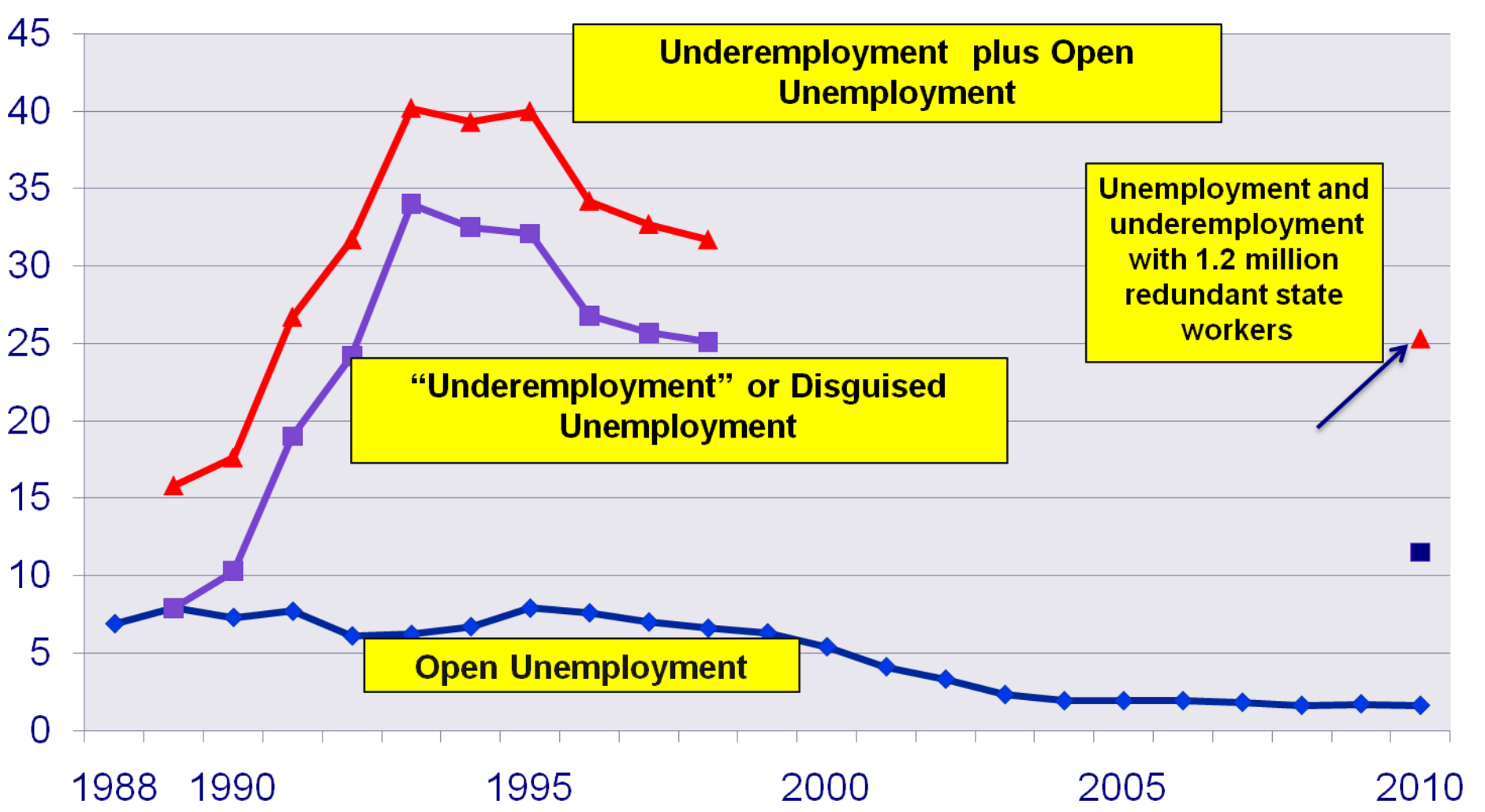


Chart 9 Unemployment and Underemployment in Cuba, 1988-2010



Source: Carmelo Mesa-Lago: "Convirtiendo el Desempleo Oculto en Visible en Cuba" Espacio Laical, Havana Cuba. And Comisión Económica para América Latina y el Caribe (CEPAL). 1997, 2000. *La Economía Cubana: Reformas Estructurales y Desempeño en los Noventa* (México DF: Fondo de Cultura Económica, 1ª y 2ª ediciones).

Causes of Economic Problems

- **Not Weak Human Development; Not laziness;
Not weak entrepreneurship**
- **Instead: problems are due to**
 - **A Central Policy Mess-Up: The Monetary and Exchange Rate System**
 - **Misguided policies;**
 - **Institutional deformations:**
 - excessive expansion of state sector;**
 - **Insufficient role for market mechanism;**
 - **Innumerable bureaucratic controls in labor, product, financial and capital markets;**
 - **Induce people to undertake unproductive actions**
 - **Thence the underground economy, pilferage, black markets**

II. Raul Castro's Approach to Reform



“We confront unpleasant realities, but we are not closing our eyes to them. We are convinced that we must break dogmas and we affirm with firmness and confidence the implementation, already in process, of ‘*our economic model*’”.

Raul Castro

**“Draft Guide for
Economic and
Social Policy” of
October 2010**



VI CONGRESO DEL PARTIDO COMUNISTA DE CUBA

**PROYECTO
DE LINEAMIENTOS
DE LA POLÍTICA
ECONÓMICA Y SOCIAL**

1ro. de noviembre de 2010
«Año 52 de la Revolución»

Ambitious Intentions for Economic and Social Policy (291 guidelines, goals, or recommendations)

- I Economic Management Model (38)**
- II Macroeconomic Policies (25)**
- III External Economic Policies (44)**
- IV Investment Policy (13)**
- V Science, Technology and Innovation Policy (7)**
- VI Social Policy (36)**
- VII Agro-industrial Policy (31)**
- VIII Industrial and Energy Policy (37)**
- IX Tourism Policy (13)**
- X Transport Policy (18)**
- XI Construction, Housing, and Water Policy (14)**
- XII Commercial Policy (9)**

Essential Character:

- Purely economic, **no political elements**
- Not a “Plan”; Maybe a “**Pre-strategy**”
- Ambitious and comprehensive
- A statement of aspirations; a “**Wish-list**”
 - **No priorities** indicated
 - **No sequencing** of policies or investments
 - **No coordination**

Does it suggest a “Viet Nameese Model” or a
“Chinese Model”? Only partially

Economic Reforms so far

Policy Changes towards Micro-Enterprise

- a) **Range of activities:** a small increase
(Still too limited)
- a) **Regulatory framework:** some relaxation
- b) **Tax regime:** minor change
(continuing rigor)
- a) **Licensing:** significant liberalization
- b) Media and **political environment** “de-stigmatized” totally !

Additional Changes:

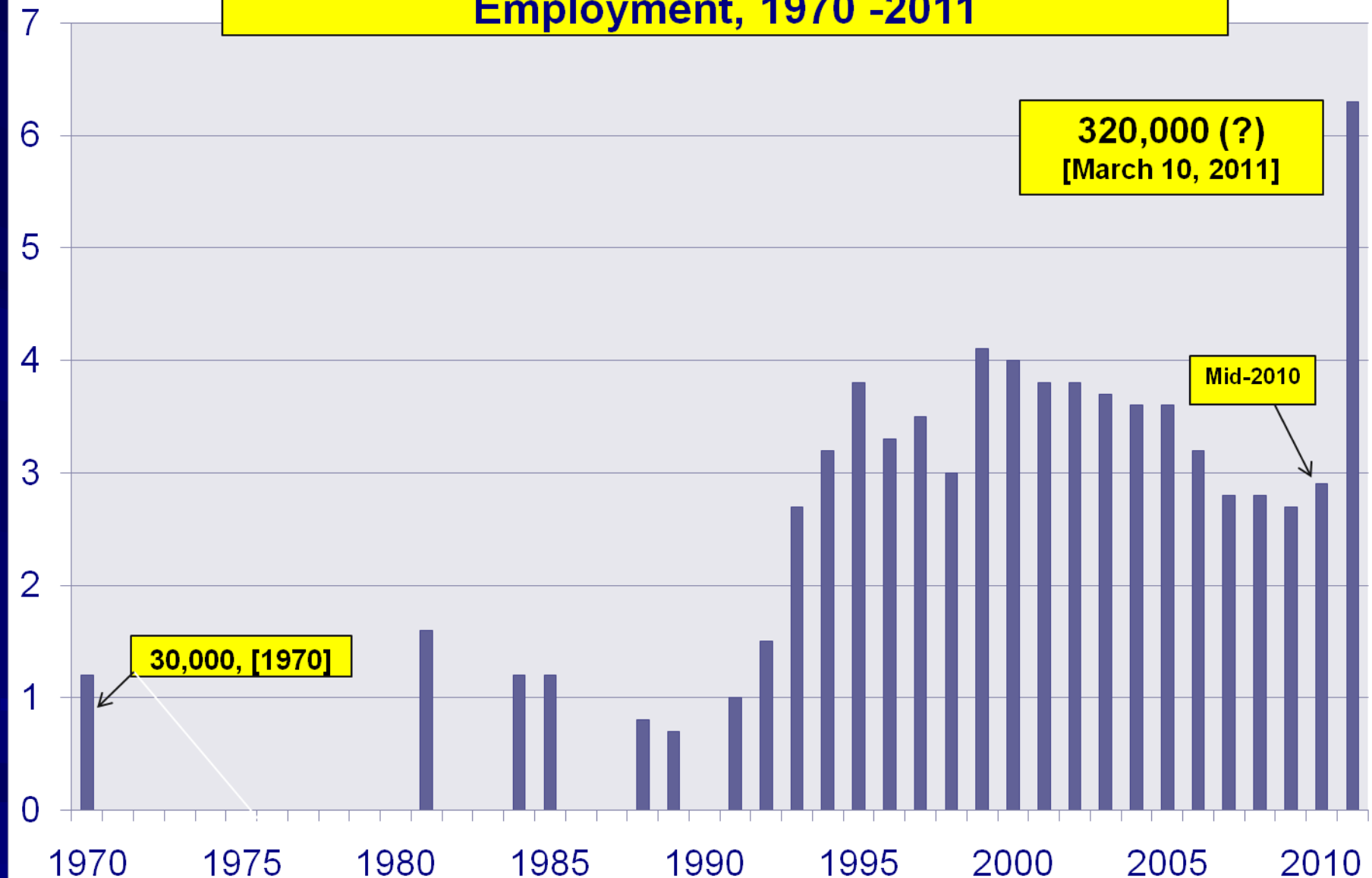
- f) Broadened eligibility for self employment:**
non-retired or non-disabled eligible
- g) Rental of facilities** from citizens or the state is easier
- h) Sales to state entities** is now possible;
- i) Use of banking** facilities and bank credit will be possible;
- j) Cooperative ventures** are now encouraged (taxis, beauticians)

Conclude: Some improvement, but further reforms are needed

III. Results?

- Expansion of Small Enterprise and **job creation has been too slow** to absorb 500,000 by March 1, 2011, or 1.2 million by December 2012
 - 171,000 new licenses by March 10, 2011
- Proposed **shock therapy re employment was too brutal to be implemented:**
- **Firing of workers decelerated.**

Chart 10 Self-Employment as a Percent of Total Employment, 1970 -2011



Other Policy Initiatives: July 2006-May 2012

2006

Permission for Cuban citizens to use tourist hotel facilities

Permission to acquire personal cellular phone contracts

Permission to rent cars previously reserved for foreigners

Relaxation of rules regarding purchase of computers, DVD players, etc.

“Resolution on Regulations for Labor Discipline”

2007

Legalization of hard-currency salary supplements to Cuban employees of foreign joint ventures

2008

Decree-Law No. 259: ten-year leases of unused state land to small farmers

Decree Law No. 260, Financial incentives to attract teachers back to their profession

2009

Replacement of Fidel Castro's economic team and resignation of the President of the Central Bank

Proposal to reduce subsidization of rationed products

Replacement of worker's dining facilities with an income increase

2010

Relaxation of restrictions on private taxis

Experiment with cooperative beauty and barber shops

Markets for inputs for small farmers

Raising of retirement ages from 55 to 60 for women and from 60 to 65 for men

Liberalization of sale of building materials to citizens

Legalization of 99-year leasing of land to foreign tourist companies (August 13, 2010)

Announcement of Lay-offs of 500,000 state sector workers to be incorporated into self-employment. (September 1)

2011

Direct conversion of state properties to private activities
(preferably cooperatives)

**Home Ownership: direct citizen-to-citizen sales at
market determined prices probable**

Establishment of an open market for vehicles

An emphasis on cooperative-types of organization; details in
process

Modification of Educational System:

Reducing University enrolment ;

Reversing Fidel's University in Every Municipality approach

Is the Reform Process Sustainable?

Yes

- The “*Fidelista Model*” is discredited
- Fidel is irrelevant and discredited;
- “Fidelistas” are also discredited
 - By current realities,
 - By the “Proyecto de Linamientos...”
 - By Raul’s statements and speeches regarding the need for a new economic approach
 - By publicity re the need for a new approach
- *Fidelista* Ministers have been replaced by *Raulistas*;
- Virtually no criticism from the left inside or outside Cuba

- Raul's military colleagues have moved into management throughout the economy
 - Raul and the military: pragmatic since the 1990s
 - But **management militarization is also problematic;**
- Raul appears to have emerged from the shadow of his elder brother;

Raul seems to want his own economic model;

Raul seems to want his own legacy

Could the Reform Process Accelerate?

■ Improbable as long as Raul is in Charge

- Cautious but deliberate;
- Original Revolutionary generation still in command;
- Fear of Russian style melt-down;
- Fear of loss of political control & Party monopoly;
- Political pressures from heightened expectations ?

Under what conditions might the reform process accelerate?

- If “Generational Change” occurs soon and the gerontocrats leave the scene;**
- If Venezuelan support stopped, generating recession;**
- If no off-shore petroleum is found;**
- If other factors led to renewed recession;**
- If expectations were further heightened but unrealized**

Might the Reform Process Decelerate?

- Maybe, if Cuba becomes a “petro-power” increasing foreign exchange earnings dramatically
 - Will Cuba experience the “Resource Curse” phenomenon ??
- Maybe, as long as Chavez remains in power
- Maybe, if other factors lead to renewed economic prosperity

Probable economic performance in 2012

Foreign Exchange Earnings: Modest expansion.

- Tourism: Steadily increasing;
- Nickel : Prices okay; volumes expanding
- Traditional exports: Okay
- Pharmaceuticals : Promising outside Venezuela
- Other merchandise exports : Generally weak.
- Venezuelan support seems assured for the year

Investment Levels:

Domestic investment volumes weak

**But micro-enterprise investments are increasing
and bear fruit fast;**

**Significant positive impacts on daily material life
for citizens**

Foreign Investment modestly positive:

Marinel Port Development now;

Sherritt International Nickel expansion;

Off-Shore Petroleum exploration on-going;

Hotel / golf expansions delayed;

Possible Brazilian Investment in Sugar/Ethanol ?

Possible Chinese investments ??

The Changing Geo-Economic Environment

- Venezuela,
- China,
- Brazil, and
- USA

The Changing Geo-Economic Environment

Special Relationship with Venezuela:

Merchandise Exports to Ven. (2010): **\$1.727** million or 37.7% of Total
Merchandise Imports from Ven. **\$4,300** million or 40.4% of Total
(ONE, AEC, 2011)

Oil Import Subsidy: (1% interest, 25 year repayment, 40% of imports)
My estimate for 2010 +/- **\$1,168 million**

Cuba's **Service Exports to Venezuela.:** up to \$ 6,000 million

Cuba's Total Export of Pharmaceuticals to Ven. in 2010: **\$164 Million**

Direct Subsidization in 2010 : \$ 1.2 to 2 Billion;

Special Trade Deals

(Doctors, etc. at politically determined prices)

Unclear, perhaps exceeding \$ 6 Billion

Sustainability ?

Unsustainable in long run due to their political character;

Doctor's services: too valuable to be cut quickly, but also unsustainable in the long run.

Emerging Relationship with China

Second major trading partner in 2010;

Cuba's Imports: \$1,223,5 million

The major source of low-cost manufactures

Cuba's Exports: \$ 677.3 million (nickel mainly)

Possible future investment

Off-Shore Petroleum and refining;

Manufacturing;

Hotels

Prospects: Promising

Ideological affinity;

Nickel and agriculture are of interest to China

Downside: Is China also “de-industrializing” Cuba?

Relationship with Brazil:

Trade: Major expansion of Cuba's imports from
Brazil to +/- \$ 450 million

Brazilian Investment:

Mariel port project: +/- \$ 960 million

Sugar/ethanol investment appears probable;

Off-shore petroleum exploration dormant

Some small investment activities;

Some technical assistance

**Cuba: a useful medium for Brazilian diplomatic
ambitions in the region**

Relations with the United States:

Normalization would be positive for Cuba
(and for the United States)

- **Tourism bonanza** for Cuba
 - (Curiosity, sun/sea/sand, "snow-bird", retiree, convention, "March-Breaker" tourism would all "break loose")
- Access to a major **new export market**;
- Major **Investment potential**, esp. from Cuban-American community;
- Major **Technological transfers** would be promoted
- Promotion of numerous types of **financial flows**
(informal; NGOs micro-credits; supplier's credits; bank loans; portfolio investments, IDB loans etc.) ;

**Normalization would help Cuba become a
"normal " country**

Possible Future Scenarios:

1. Continuing Moderate Reform
2. Petro-Power Party Patronage Regime
3. The “Chinese Model”
4. Move to “Normal” Mixed Market Economy

2. Petro-Power Party Patronage Regime: Moderate reforms, plus a Petroleum Bonanza

Assumptions:

- **Successful off-shore oil development;**
- **Three to 8 year Time Horizon**
- **Political Status Quo: Communist Party dominance continues;**
- **Venezuela support may or may not continue**
- **China orientation continues**
- **No US-Cuba Normalization**

Consequences:

- **Possibility A. Moderate BoP Support;**
 - Encouraging diversified expansion
 - Promoting growth and prosperity
- **Possibility B. The “Curse of Resource Wealth”?**
 - Economy driven back to “mono-exportation” via exchange rate impact (like Saudi Arabia, Venezuela etc.)
 - Recall the sugar bonanza: “Dance of the Millions”

Political Implications in each case:

- Wind-fall Oil Revenues **feed the Party Patronage machine**; strengthen central political control;
- **Amplified potential for corruption** over and above the pervasive Party patronage

3. Possible “Chinese” Model

Assumptions:

- Political Status Quo: Communist Party monopoly continues
- Major *Apertura* to Foreign Investment
- More effective domestic “Marketization”
- Effective macro-economic management (re monetary policy and the exchange rate)
- With or without Chavez support
- Successful Export-Orientation
- Time-Horizon: from Year 2 to Year 15

Probable Consequences:

- Strengthened Party Control**
- No Authentic Democratization or Human Rights Improvements**
- Continuing Political Repression,**
- Greater Economic Prosperity**
- Improving Economic Liberties (travel, tourism, trade, enterprise)**

4. Rapid Move to “Normal” Mixed Market Economy

■ Cuba as a “Normal Country”: Characteristics:

- Further Internal Economic Liberalization**
- Enhanced Economic Apertura**
(re DFI, Trade, Financial Flows, IFIs)
- Productive Relations with Exile Diaspora**
- Transition to Political Pluralism and Human Rights**
- Normalization with the United States**

Main Economic Consequences:

- Accelerated and more complete technological transfer to all areas of economy;
- Stimulation of economic growth
- Cuba becomes an economic Gateway
 - to Latin America from North America;
 - from Latin America to North America

■ Preconditions:

- Emergence of Reformist Leadership;
- Shift to genuine political pluralism
- Normalization with the United States

■ Probability:

- | | | |
|----------------|------------|-----|
| – Short run, | 2009-2014: | 5% |
| – Longer Term, | 2021-2026: | 70% |

V. Alternate Scenarios:

Scenario	Probability		
	2012-15	2015-20	2021-25
1. Gradualist Moderate Reform	60%	25%	0%
2. Petroleum Party Patronage Paradigm	10%	30%	20%
3. Chinese Model	15%	25%	10%
4. “Normal Economy” and “Polity” Model	5%	20%	70%

Optimistic again! (as in 1993)

- Raul is pragmatic and deliberative; accepts hard truths and takes strong actions;
- Fidel and the *Fidelistas* are in permanent eclipse;
- Generational change will happen;
- Problems are being tackled;
- Climate of opinion is reformist;
- Heightened popular expectations for change are increasingly difficult to ignore;
- Slightly greater toleration of critical views, despite “Cyber-wars”, Blogger Battles and short-term arrests;
- **Entrepreneurship, Ingenuity, and Creativity of the Cuban People; “Human Capital”**
- **Wishful Thinking??**

To Conclude:

- **Economic situation is difficult;**
- **Policy changes are in the right direction but reforms so far are timid;**
- **Major uncertainties re Chavez support and petroleum;**
- **A dynamic towards further gradual reform is in motion and will continue;**



Thank You Very Much