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
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.

New GDP Measure
Adopted, 2004

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)
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)

Source: NU CEPAL, 2000 Tables A.36 and A.37, and ONE, AEC, Various Years.
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
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

- Agriculture, Fishing and Mining: 4.3%
- Manufacturing (excl. Sugar): 13.4%
- Construction: 5%
- Electricity, Gas, Water: 1.6%
- Transportation: 8.8%
- Health & Education: 24.9%
- Other Services: 40.2%
- Sugar: 0.7%

Source: ONE, 2011 Table 5.5
Chart 7A Cuban Exports By Product Shares, 2010
Total: 13,399 Million Cuban Pesos

- Sugar, 266.1
- Alcoholic Beverages, 202.2
- Tobacco, 82.8
- Fish, 59.7
- Pharmaceutical, 491.4
- Other Manufactures, 176.2
- Transportation equipment, 111.4
- Other Merchandise, 1105.3
- Merchandise Exports Unaccounted For: 1,522
- Tourism, 2218.4
- Other Services (Health and Education mainly) 6,583

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)

<table>
<thead>
<tr>
<th>Destination</th>
<th>Millions of $US</th>
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<tbody>
<tr>
<td>Rest of Europe</td>
<td>342</td>
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<tr>
<td>Netherlands</td>
<td>359.3</td>
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<tr>
<td>Spain</td>
<td>161</td>
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<tr>
<td>Africa</td>
<td>187</td>
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<tr>
<td>Rest of Asia</td>
<td>278.5</td>
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<tr>
<td>China</td>
<td>677.3</td>
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<tr>
<td>Canada</td>
<td>640.6</td>
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<tr>
<td>Rest of L.A.C.</td>
<td>224</td>
</tr>
<tr>
<td>Venezuela</td>
<td>1727.1</td>
</tr>
</tbody>
</table>

ONE, 2011, Chart 8.5
Chart 8  Cuba’s Merchandise Imports by Source, 2010  (Total: $10,646.8 million)

Millions of $US

- Rest of Asia: 386.1
- Viet Nam: 226
- China: 1223.5
- Rest of Europe: 585.3
- Russia: 227
- Italy: 293
- Germany: 268
- Spain: 786
- Africa: 222.4
- Rest of Latin..: 899.1
- Brazil: 443.6
- Canada: 331.2
- United States..: 410.6
- Venezuela: 4300.6
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

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
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 Namese 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** “destigmatized” 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

Source: ONE: Anuario Estadistico de Cuba, various issues
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:

Mariel 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%
## Alternate Scenarios:

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<tbody>
<tr>
<td>1. Gradualist Moderate Reform</td>
<td>60%</td>
<td>25%</td>
<td>0%</td>
</tr>
<tr>
<td>2. Petroleum Party Patronage Paradigm</td>
<td>10%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>3. Chinese Model</td>
<td>15%</td>
<td>25%</td>
<td>10%</td>
</tr>
<tr>
<td>4. “Normal Economy” and “Polity” Model</td>
<td>5%</td>
<td>20%</td>
<td>70%</td>
</tr>
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</table>
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