

WHERE IS CUBA GOING? ECONOMIC POLICIES THAT HAVE BEEN ADOPTED AND RESULTS THUS FAR

Joaquín P. Pujol

Since taking over as ruler of Cuba in 2008, Raúl Castro has adopted a number of economic policies that seek to reverse declining productivity, slow economic growth and serious balance of payments disequilibrium. His government has exhorted citizens to consume less, save more and work harder. In his first speech as president in February 2008, Raúl promised to make the government smaller and more efficient, to consider the potential revaluation of the Cuban peso, and to eliminate excessive bans and regulations that curb productivity.

This paper reviews areas addressed by policy initiatives of Raúl Castro's government and results to date. In particular, the following ten policy areas are discussed: (1) liberalizing agricultural activities; (2) reducing government expenditures and of the role of government ministries and entities; (3) reducing public sector employment; (4) allowing some private activities, in the form of self-employment, small entrepreneurs, cooperatives; (5) eliminating some excessive prohibitions; (6) revising tax policies; (7) extending credit to some private activities; (8) addressing housing and transportation shortages; (9) intensifying oil exploration; and (10) seeking new credits and investments from friendly governments and intensifying the lobbying efforts to lift the U.S. embargo.

LIBERALIZING AGRICULTURAL ACTIVITIES

Agriculture is very important for the Cuban economy, not only because of its potential to provide food to feed the population, but also because of its direct and indirect participation in the composition of the

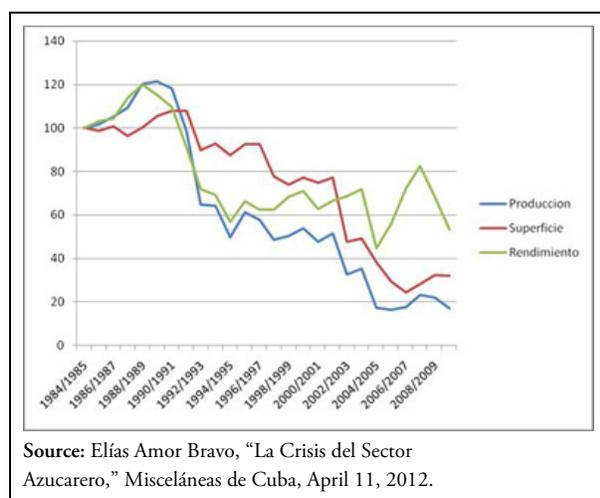
Gross Domestic Product (GDP) and its multiplier effects on other domestic activities. To the extent that this sector fails to meet production targets, it results in significant expenditures to import foodstuffs for domestic consumption. This is part of what has been happening in recent years. The problem was further aggravated by the rise of world market food prices and the impact of several hurricanes. Thus, agriculture has been a sector that has attracted the attention of Raúl Castro from the very beginning of his administration.

The performance of Cuba's agricultural sector is somewhat of a paradox. Cuba has over 1.8 million hectares of cultivable land that is currently fallow, while it has to import 80% of food consumed domestically. Most of this land was confiscated from private owners in the 1960s and has been in the hands of the public sector since then. The bulk of it was unattended after Fidel Castro made the decision to wind down sugar cane cultivation and has been invaded by *marabú*, an invasive shrub that is difficult to eradicate.

Sugar production declined sharply after the collapse of the Soviet Union and the loss of that subsidized market for Cuban exports, but this trend has continued in subsequent years. In 2003, a decision was made to shut down much of the sugar production sector; 71 of 156 sugar mills were closed and slated for dismantling, with only about 30 left in operation. As a result, sugar production collapsed to around 2 million tons per annum since 2005 (a historic low compared with an average of roughly 8 million tons

per annum in the 1980s). The destruction of the productive base of the industry in sugar mill towns had a major negative impact on regional development and employment and on the viability of the cluster of economic activities surrounding the sugar sector. The shutdown of the sugar sector has been an economic calamity for Cuba and, despite later efforts to revitalize sugar production, both output and yields have continued to decline. Currently Cuban sugar production is just around 2 million tons, about one third of that produced 15 to 20 years ago.

Figure 1. Cuban Sugar Production, Area under Cultivation, and Yield (1984/1985 = 100)



In an effort to boost food production, the government began in 2008 to distribute small plots of land to private farmers in usufruct, and to give farmers more discretion over how to use their land and what supplies to buy. Under the new policy (Decree-Laws No. 259 and 282), private farmers and cooperatives can be granted land in usufruct for a period of ten years (with the possibility of renewal). State bureaucrats were ordered to stop favoring State farms over privately-run farms with respect to the allocation of inputs, and the regulations allowing farmers to sell directly to consumers, including tourist hotels, were loosened somewhat. The goal was to achieve self-sufficiency in food production. Payment levels to farmers by the Government marketing monopoly (ACOPIO) for milk, beef, and some other agricul-

tural products were raised, and certain decisions which previously were made by Central Government Ministries concerning the crop to be produced, the allocations of inputs to farmers, as well as the processing and transportation of produce were decentralized to the municipal level.

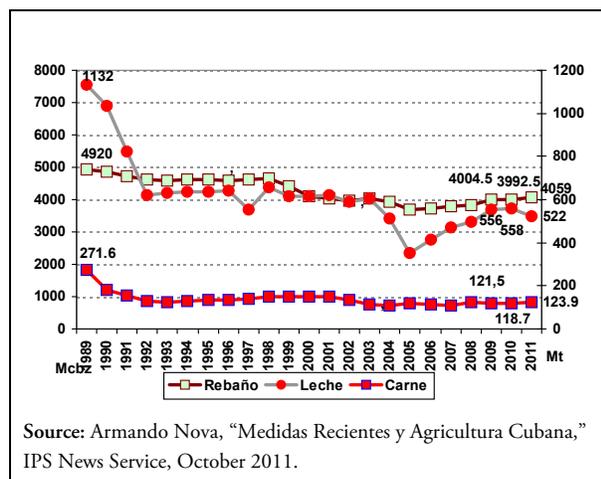
However, the manner in which land granted in usufruct would be exploited and the products produced was still subject to government approval, and about 70% of the output would still have to be turned over to ACOPIO. Another shortcoming of the new regulations was that they did not allow farmers to build housing units or facilities to store equipment (more recently this has been authorized) on the land granted in usufruct, and the State still held a monopoly over the supply of most inputs and equipment required for production. Reportedly, only 25% percent of the previously fallow land is being exploited.

Despite these reform efforts, overall food production has been reported to be significantly below targets, with shortages of some basic agricultural products in Havana and elsewhere. Once a large net agricultural exporter, Cuba has become a huge net food importer, mainly from the United States. Even staple food crops—root crops, plantains, onions, garlic, papaya, squash, and cabbage—declined in 2011. Livestock production fell in 2011 as well. Agricultural yields in the State sector have declined in all product categories since 2007, except for certain fruits and rice.

Continuing problems in the agricultural sector center on an entrenched system whereby farmers depend on the state for fuel, pesticides, fertilizers and other resources in exchange for 70%-80% of what they produce. The government's inability to provide sufficient inputs to farmers has hampered production, and its domination of the distribution process has done the same with respect to the delivery of products to the market. It should be noted that one of the sources of loss of competitiveness of the agricultural sector, and in particular of sugar production, has been the prevalence of an overvalued exchange rate for the peso which endears the cost of imported inputs, and as a consequence makes these activities less attractive to producers. The stagnation of the agricultural sector is reflected also in meat and milk produc-

tion (Figure 2), which has been basically unchanged in the last decade. Milk production declined by 39 million liters in 2011; by May 2012 only 5,674 grocery stores were receiving milk directly from farmers, 810 fewer than at the beginning of the year. Finally, Cuban coffee production is now about half that of the early 1990s, and fell to 28% of that of the early 2000s. Cuba now mixes coffee beans with soya for domestic consumption.

Figure 2. Stock of Cattle and Production of Meat and Milk, 1989–2011



At least three major policy issues are hindering progress of the agricultural sector: (1) the lack of property rights; (2) the lack of recognition of a role for the free market in determining demand and supply; and (3) the lack of a systemic approach through the production-distribution-marketing-consumption process that recognizes the interrelations between macro and micro economic forces. A number of suggestions have been made to allow producers to take responsibility for their own decisions and own the results of their work, which should encourage them to seek a more efficient production and distribution of their output using the market:

- Consolidation of the markets for inputs and other production goods, so that the farmers can obtain what they need according to their buying power and have access to them at the right time and at prices consistent with what they will be paid for their output.

- Producers should be able to decide what they are going to produce, to whom they will sell it, and the prices at which they will do so, based on market forces.
- Alternatives to the ACOPIO state monopoly should be provided for the commercialization of produce such as through marketing cooperatives, allowing direct sales to retail outlets and consumers and even exports.
- Farmers should be allowed to hire laborers and to have access to technical assistance and financing.

Recently, steps have been taken to allow contracting of laborers for certain types of activities, access to micro credits, and some decentralization of the commercialization of agricultural products in the retail market as well as direct sales to tourist facilities. To date, all of these steps have been limited in scope: while the authorization to allow farmers to sell their produce directly to tourist hotels at first led to 422 productive units signing contracts to do so, only 45 of them remain in place.

It is worth pointing out that the agricultural producers that exhibit the greatest production efficiency are cooperatives and private farmers, which produce about 57% of total agricultural output and 56% of the milk, while they only occupy 24% of the total arable land, the rest being in the hands of large State-run farms.

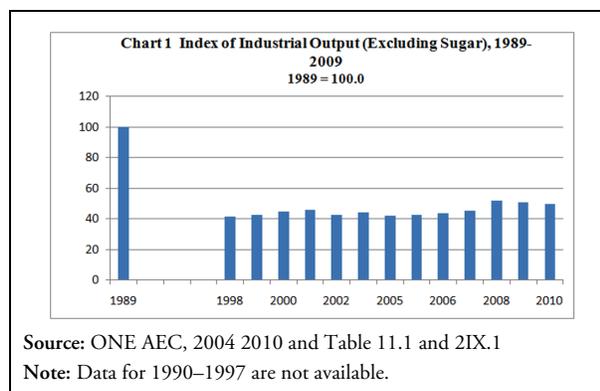
REDUCING GOVERNMENT EXPENDITURES AND THE ROLE OF THE GOVERNMENT IN THE ECONOMY

Cuba's economic model suffers from excessive concentration in state decision-making and ownership of the means of production, as well as lack of incentives and low efficiency, which have impaired output and productivity growth. They have worsened during the last decade due to structural weaknesses in the pattern of growth: reliance on the export of medical and other personal services which have a very low domestic multiplier effect, increase in the external debt and dependence on imports. A domestic consensus has arisen that the centralized state economic model needs profound structural changes. At the same time there is need to improve the state's regulatory func-

tions by reducing the financial burden of state activities and services the state provides.

Industrial output declined sharply after the collapse of the Soviet Union and has remained practically stagnant since 1998. Official data sources indicate that industrial production in 2010 was still a fraction of that of 1989 (i.e., before the end of Soviet aid) and that it actually showed some contraction since 2008 (see Figure 3). Lower levels of agricultural production had as a consequence an increase in government expenditures in the importation of food, which was further exacerbated by the rise of the prices for these products in international markets and the destruction of some crops by several hurricanes that hit the island in recent years. This contributed not only to an increase in the balance of payments deficit but also to a widening of the fiscal deficit, from levels equivalent to about 4% in earlier years to as high as 6.7% in 2008, which the government realized could not be sustained.

Figure 3. Stagnation of Domestic Industrial Output



In 2009, following a detailed review, a decision was made to cut back expenditures across the board by 6%. This involved not only a reduction in all kinds of imports, but also those involving investments and even “social expenditures.” Thus, employer-provided lunches for workers were substituted for stipends and government-run cafeterias were closed or turned over to be run by private individuals or cooperatives. There was a significant reduction in university enrollment and the program of municipal universities was dismantled, as were “schools in the countryside,”

where young students were sent for work-study programs and indoctrination.

Concerning social expenditures, there has been some public discussion of discontinuing the availability of subsidized consumer products through the rationing card, although the system currently covers less than half of people’s food needs. Progressively, the number of products sold at subsidized prices has been reduced, or the amounts made available substantially cut back, resulting in a decline in the availability of certain important consumer products to the population. One consequence of this measure was an increase in the average price of agricultural and meat products in markets outside of the rationing system of some 19.8%. Expenditures in education and healthcare also have been reduced.

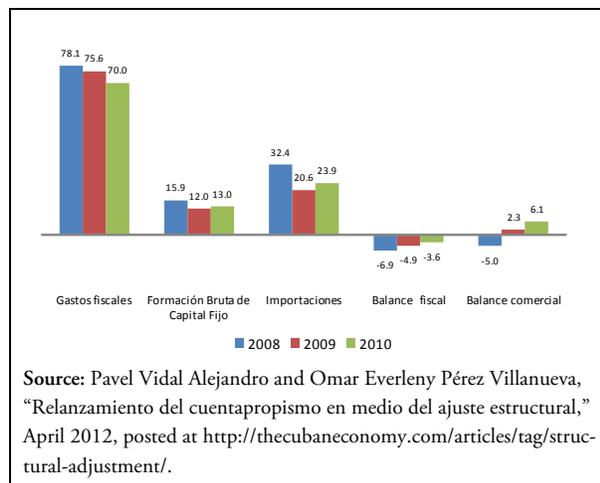
With respect to investment expenditures, a large number of projects were postponed or discontinued. As a consequence, there was further neglect of maintenance and repair of plant and equipment. According to the Economic Commission for Latin America (ECLA), Cuba’s total investment in 2011 amounted to only 8.2% of estimated GDP as compared to 21.9% for the rest of Latin America, a level not sufficient even to cover for depreciation of existing facilities.

The reduction in public expenditures had a positive impact on government finances, allowing for a decline in the fiscal imbalance (from a deficit equivalent to 6.9% of National Income in 2008 to 3.6% by 2010), and a significant improvement in the external balance (which turned from a deficit of 5% in 2008 to a surplus of 6.1% in 2010). This allowed for the release by the end of 2011 of a number of foreign frozen exchange accounts belonging to foreign operators and made it possible to resume some servicing of Cuba’s short term external obligations (Figure 4).

REDUCING PUBLIC SECTOR EMPLOYMENT

In an effort to rationalize public sector employment and increase its productivity, the government decided to retrench some 20% of total government employees (about one million workers), who were determined to be redundant, and to close a number of public sector enterprises and consolidate government ministries. For example, the Ministries of Foreign

Figure 4. Fiscal Expenditures, Gross Capital Formation, Imports, Fiscal Balance, External Commercial Balance



Trade and of Foreign Investment and Economic Cooperation were merged, and the Fishing Ministry merged with the Food Industry Ministry.

In April 2008, the Cuban government announced that it would begin revamping the state's wage system by removing the limit on how much a state worker could earn and tying individual wages to his or her productivity rather than overall enterprise performance. (Previously all workers received practically the same very low level of wages irrespective of how hard they worked or their productivity.) Moreover, individuals would be able to hold more than one job and those already retired could hold a job and still retain their pensions. These measures were an effort to boost productivity and to deal with one of Cuba's major economic problems: how to raise wages to a level that could satisfy basic human needs. The promised revamp of the wage system, however, has been delayed, reportedly by poor preparation and bureaucratic opposition.

As mentioned above, one of actions to revitalize the economy was to eliminate one million redundant workers from the State payrolls. To prevent such a high number of retrenched workers from driving up unemployment, actions were announced to authorize the operation of a number of non-state activities (previously prohibited)—in the form of self-employ-

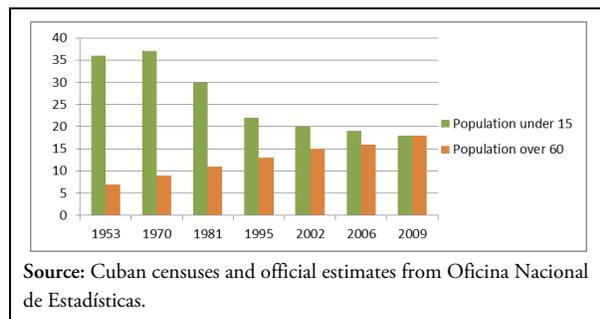
ment, small enterprises in the service sector and individual small farmers and cooperatives—with the expectation that they would help absorb the personnel being shed by the State. Additional steps provided some flexibility in the labor market, such as the authorization to work in more than one job, the elimination of wage ceilings, permission for state enterprises to set salaries based on individual workers' productivity, and legalization of hard currency salary supplements to Cuban employees of foreign joint ventures.

The low productivity of the public sector is worsened by social factors such as the ongoing demographic transition, which is characterized by a rise in the population over 60 years old at the same time that there is a decline in the population under fifteen years old (Figure 5). There are too few children and too many elderly. Cuba's population is now the oldest in the hemisphere. The falling birth rates—partly a result of high abortion rates—and the long life expectancy mean not only that the population has not grown over the past five years, but that the elderly are slowly replacing youths.

The problem is further complicated by the exodus of young people. Under the Communist regime Cuba has changed from a country of immigrants to a country of emigrants. The work force has begun to drop absolutely; and there are now fewer workers to support the retirees. Authorities recently asked seniors to keep active later in life by rolling the retirement age progressively back from 55 to 60 years of age for women and from 60 to 65 years for men. Cuba recently allowed retirees to return to work and still collect their pensions, and financial incentives have been provided to attract retired teachers back to their profession.

Immigration data shows more Cubans have arrived in the United States over the past 20 years than during 1970–90, and the illegal exodus continues. Studies of immigration flows normally reveal that migrants tend to be the youngest, the more ambitious, and the ones with lesser ties at home. Migration aggravates the demographic situation because migrants are the people who not only would contribute to the economy but would also have children of

Figure 5. Aging of Cuba's Population
(% of population in each cohort)



their own. The children of Cuban emigrants, rather than being born in the island, are being born in the United States, or will be born in the United States.

Cuba's aging population will test economic reform. Cuba's National Office of Statistics reports about 2 million of the island's 11 million inhabitants, or 17%, were over 60 years old last year. This is high compared to Latin America as a whole, where the share is somewhere north of 9%, extrapolating from U.N. figures for 2000. The number of seniors is projected to nearly double to 3.6 million, or a third of the population, by 2035. During the same period, working-age Cubans are expected to decline from 65% to 52%. By 2021, more Cubans will be leaving the workforce than entering, according to government projections. The population is shrinking, ageing—and emigrating.

ALLOWING SOME PRIVATE ACTIVITIES— SELF-EMPLOYMENT, SMALL ENTREPRENEURS, COOPERATIVES

One of the pillars of the economic policy strategy adopted by the Cuban government is allowing certain self-employment activities and the operation of small non governmental enterprises in the service sector and in agriculture. It has also been announced that the establishment of small cooperatives in areas beyond agriculture may also be authorized.

After the collapse of the Soviet Union, Cuba suffered a severe economic depression and in 1989 the Gov-

ernment authorized some private activities under the umbrella of “self-employment.” Subsequently, the government began to interfere with self-employment and the number of licenses issued by the government for self-employment remained flat.

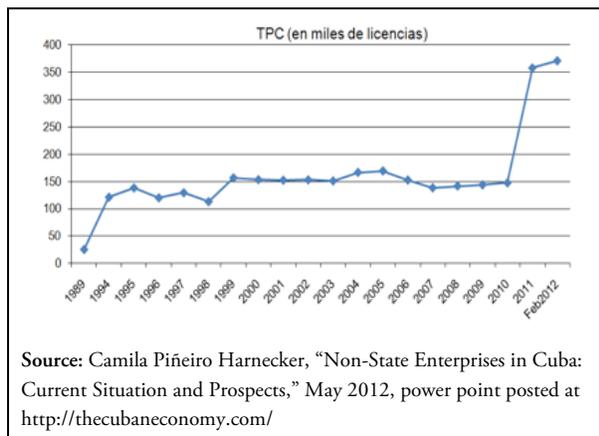
In September 2010, at the time that the government announced the intention to eliminate up to 1 million public sector jobs, it also announced that some 181 types of activities would be authorized to operate as self-employed.

By the beginning of 2012, some 380,000 persons had obtained licenses for self-employment (see Figure 6). These authorizations, however, excluded all professional activities and, in fact, practically all of them were in the service sector. Mixed-economy nations typically issue a list of sectors or industries where the state predominates; the rest of economic activities are the purview of the private sector. Cuba has done the reverse: it permits 181 “non state” activities that are mostly trivial in terms of importance within the economy—party clowns, hair dressers, taxi-drivers. True private firms are not allowed, although the authorities claim they are considering expanding “non-state” activities in the form of cooperatives. With the exception of very small farmers, who retained their land during the nationalization of the 1960s, cooperatives in Cuba have meant state controlled institutions. While the now-famous *paladares* (small, home-based restaurants) have been allowed to expand from 12 seats to 50, the recent closure by the government of a very successful night club-*paladar* after media focus on its success (and unfavorable comparisons with state-run clubs) has raised cautionary flags among potential new entrepreneurs.¹

A survey taken by the Cuban government in August 2011 shows that relatively few of those who received self-employment licenses had been working for the government prior to receiving the license: 67% were previously unemployed (or were carrying on self-employment activities without a license) and only 17 % were either former State employees or retirees. The

1. The night club, called “El Cabildo,” operated in Havana. It was said to be the largest private enterprise in the island, employing about 130 persons.

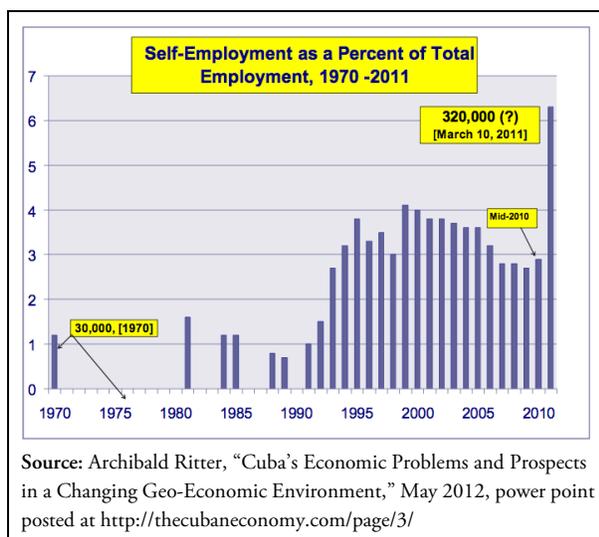
Figure 6. Self-Employment Licenses Granted (in thousands)



most common activities of the self-employed were cafeterias, restaurant or food vendors (20%), contract/hired laborers (17%), transport (10%), producer/vendor of supplies for households (4%), bed and breakfast operators (4%) and street vendors (3%).

Self-employment and other private activities were expected to eventually provide employment for the estimated one million government workers that had been identified as redundant. It was expected that by 2015 more than 35% of the labor force would be employed in activities outside the public sector. In fact, by mid-2011 they represented less than 6.5% of total employment (see Figure 7).

Figure 7. Self-Employment Licenses Granted (in thousands)



The regulatory framework for self-employment has progressively become more flexible. Self-employed workers are now allowed to contract workers for their activities, they can sell their goods and services to State enterprises, they are eligible to contribute and to receive Social Security pensions, they can rent space and equipment from the State and other private individuals or business, and an individual may hold more than one license. But there are still many limitations to the self-employment activities.

In 2011, state banks were authorized to begin giving micro credits for agriculture or home repairs (loan amounts were capped at \$125 to \$200), and restrictions limiting the use of checking accounts, bank transfers and the use of debit or credit cards by private sector individuals for certain payments were lifted. At the end of 2011, some property sales (of automobiles and houses) were legalized and permission was granted for the construction of homes and some other structures in the land granted in usufruct to farmers.

In July 2012, the authorities announced a pilot program that will convert 222 state-owned companies into worker-run cooperatives. However, the government will maintain ownership of the company's physical property and charge rent to the cooperative, but members will be able to determine their own hours, pay and leadership.

REMOVING EXCESSIVE PROHIBITIONS

Among the measures to liberalize the economy adopted in early 2008, Cubans were permitted to use cell phones, stay at tourist hotels, rent cars, and purchase electronic devices. Other reforms included permitting the operation of private taxis, liberalizing the sale of building materials to individual citizens, permitting the renting of rooms in private homes to tourists, allowing the "self-employed" access to credit, allowing farmers to sell products openly, and allowing greater wage differentials among different activities and individuals. By late 2011, the authorities announced that both Cubans and foreigners could, subject to certain limitations, buy and sell houses at market determined prices and that Cubans could buy and sell automobiles.

But there are plenty of catches. Cubans can only buy second-hand cars; no new-car dealerships have been allowed. The rules on house purchases are proving so complicated that many people are still doing what they have always done: swap homes and pay each other under the table. Perhaps the biggest stumbling block to the growth of self-employment is that wholesale markets, long-promised, have yet to be authorized. Thus, restaurants and other businesses have to buy their supplies at retail prices from retail stores or, more often, from the black market. The 181 permitted categories of self-employment include trades, such as plumbing, but still exclude professions. The state remains the sole importer of food. Flagship projects involving foreign investment, such as several much-touted golf resorts, have been quietly put on hold.

As a result of the authorization to have cellular phones, there was a sharp increase in cell phone usage, with the number of lines rising from 84,000 in 2004 to 1.2 million by 2011. Cell phone usage has grown by leaps and bounds since 2008 as well. Mobile phones are available only in a local dollar-pegged currency (CUC) and service costs are very high; sending a Twitter message from a mobile phone can cost more than the average daily earnings of many Cubans. Cubans do not have Internet connectivity on their phones.

Communist-controlled Cuba still monopolizes communications in the state-controlled economy. There is no broadband Internet in Cuba and the relatively few Internet users suffer through agonizingly long waits to open an email, let alone view a photo or video. This hampers government and business operations. The National Statistical Office has reported that the number of Intranet users reached 2.6 million in 2011, up from 1.8 million in 2010, although nearly all were likely to have access through government-run computer clubs, schools and offices. Cuba reports Intranet use as Internet use even though access to the Internet is banned without government permission. There were 783,000 personal computers in the country in 2011, or 70 per 1,000 residents, though around 50% of those were in state hands.

REVISING TAX POLICIES

It was expected that the authorization of self-employment and other private activities in the form of micro-enterprises not only would help absorb the public sector work force being released, but would generate a new source of funding for the government through the license fees and taxed paid by these individuals and the “legalization” of activities that were already taking place in the black market. To be able to capture such resources legislation was introduced establishing a number of new taxes.

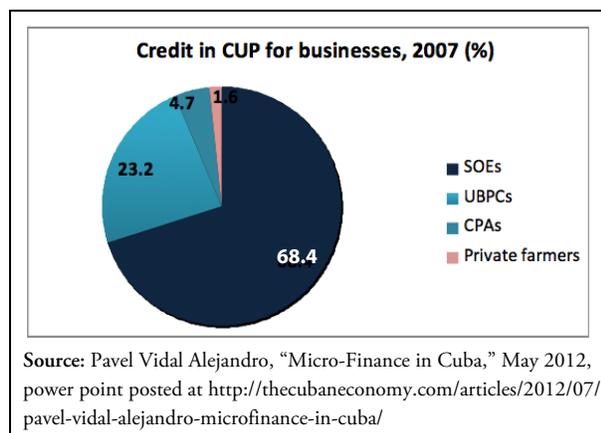
In the past the Cuban government had not applied explicit taxes on various activities. Instead, since most of the population worked for the public sector, the government appropriated most of the value added generated by the workers through the payment of subsistence wages. This was particularly visible in the case in the tourism industry, the export of medical and other services, and the operation of joint ventures with foreign investors for exports, where the government received payment for the labor hired and then turned over only a small share to the workers.

The new legislation, in addition to the licensing fees, imposed a 10% sales tax payable monthly, a payroll tax of 25% of estimated total wages for hired workers with a progressive increase in the rate depending on the number of workers hired, a personal income tax (ranging from 10% to 40%) paid annually, contributions to Social Security, and a new tax on advertising of commercial activities. Moreover, taxes were imposed on newly authorized sales of houses and automobiles.

EXTENDING CREDIT FOR PRIVATE ECONOMIC ACTIVITIES

In the past, there was little if any credit going to private activities. In 2007 private farmers received less than 2% of credit given to economic enterprises, with nearly 70% going to State-owned enterprises (SOEs) and over 23% to state-controlled agricultural cooperatives (UBPCs) (Figure 8).

In 1994 there were 2,519 State run agricultural cooperatives (UBPCs) in Cuba; at the end of 2010, 2,256 were still in existence. The UBPC were the recipient of 23% of the business credits granted by the banking system but they have a poor record of repay-

Figure 8. State Credit to Enterprises, 2007

ments. As a whole they controlled about 31% of the agricultural land of the country (Table 1); however, 23% of the land they held was left fallow, which contributed to their low productivity. It has recently been reported that some 300 of these State agricultural cooperatives are in such disarray that they will be dissolved. Moreover, the majority of the other State cooperatives will have their government debt forgiven and will be granted 25 years to pay back any outstanding bank debt. At the same time, subsidies that allow the organizations to get beneficial interest rates and lower prices for their inputs are being eliminated.

Table 1. Cooperatives in Cuba at the End of 2010

	Number of Cooperatives	Number of Members	% of Total Employment	% of Total Agricultural Land
Credit and Services Cooperatives (CSS)	2,949	362,440	7.15	35.3
Agricultural Production Cooperatives (CPA)	1,048	30,000	0.59	8.8
Basic Units of Cooperative Production (UBPC)	2,256	187,000	3.69	30.9
Total	6,253	579,440	11.44	74.0

Source: Camila Piñeiro Harnecker, "Non-State Enterprises in Cuba: Current Situation and Prospects," May 2012, power point posted at <http://thecubaneconomy.com/>

ADDRESSING HOUSING AND TRANSPORTATION SHORTAGES

At the beginning of the revolution, the government expropriated rental buildings and houses other than those occupied by the owner, abolished mortgages, and granted lessees ownership of the dwelling through monthly payments to the state over 20 years. Ill-conceived housing policies such as expropriation, lack of maintenance, and population growth in the early years of the revolution, combined with damage to housing stock from hurricanes, have contributed to a growing housing deficit. Despite some large public investments in the housing sector during the 1970s, the situation reached crisis proportions during the 1990s, and starting in 2001, there was a significant slowdown in housing construction as the government's attention was turned to other priorities. The modest number of dwellings built by the state has not made up for the destruction of the existing stock.

In 1980 individuals were authorized to build their own houses, and the total number built in that decade rose, but the housing law of 1988 tightened building and barter rules, halted the sale of construction materials to the population and imposed tough penalties for infringements. The number of new dwellings built per 1,000 inhabitants fell from 6.1 in the 1980s to 1.8 during the worst years of the crisis of the 1990s and to 1.4 in 2003–2004; it recovered somewhat in 2005–2008, and fell subsequently. While the population increased by 62% in the 50 years following the revolution, the number of dwellings constructed over this period was lower than the number destroyed due to hurricanes and lack of maintenance.

In 2006 the government prioritized new housing construction and plans were announced to build 100,000 housing units per year. As shown in Table 2, the actual number of housing units completed was considerably below the plan and actually the number of new housing units built has been declining each year since 2006. Moreover, in 2008 several hurricanes caused significant damage to the existing stock of housing, affecting over half a million units. This made the government conscious that it was not only

important to build new housing units, but also to devote resources to the repair of existing ones. But the years of poor maintenance have taken their toll and the housing situation is critical to the island's population. For 2009, the plan was to complete 43,000 housing units, equivalent to 64% of the 67,000 building that crumbled during that year; in fact, only 35,000 units were completed and even fewer in 2010 and 2011.

Table 2. Housing Construction in Cuba

Year	Number of Units Built
1990	36,326
1995	44,499
1996	57,318
1997	54,479
1998	44,963
1999	41,997
2000	42,940
2001	35,805
2002	27,460
2003	15,590
2004	15,352
2005	39,919
2006	111,373
2007	52,607
2008	44,775
2009	35,085
2010	33,901
2011	32,540

Source: Oficina Nacional de Estadísticas.

Estimates of the national housing deficit exceed a million units. Seven out of 10 houses need major repairs, according to official statistics. Some 7% of housing in Havana has formally been declared uninhabitable. The area around the capital needs some 300,000 more dwellings, and the housing problems are even worse in the interior of the country. The shortage has forced families needing additional space to build lofts and new partitions within their homes, adding strain to already-weak structures.

The housing problems have been exacerbated by a virtual state monopoly on building dwellings; tough restrictions on purchasing scarce construction materials for repairs; a notoriously inefficient centralized state agency charged with housing maintenance; and a prohibition on buying and selling dwellings (only bartering was allowed, but it was subject to a cumbersome bureaucratic process plagued with corrup-

tion). More recently, the government has shifted its approach, now allowing sale of construction materials at market prices and making available funds to help those home owners in most need repair their dwellings. Hurricane victims are a priority but anyone on a low income and in what is considered "vulnerable" housing can apply. The new grants range from 5,000 Cuban pesos (\$208) for minor repairs, to a maximum 80,000 pesos (\$3,333) for more substantial remodeling, such as addition of rooms. But supplies of building materials continue to be scarce and difficult to obtain, and many home owners turn to the black market to get them.

The overall deterioration of Cuba's basic infrastructure is well known and apparent even to casual observers. This extends to housing, public buildings, schools, waterworks, sewage systems, sidewalks, electricity distribution, streets, highways, public transportation (road and rail), and the electrical system. There are two main reasons for this. First, maintenance has been a chronic problem in centrally planned economies that place emphasis on new production and typically allocate insufficient resources to maintenance. Second, in the difficult years of the 1990s, maintenance and re-investment was postponed to release resources for urgent new investments, such as in tourism. The result is that almost all basic infrastructures are in bad shape. While maintenance and reinvestment can be postponed, insufficient maintenance can also bring about the premature demise of all types of infrastructure. The result in many parts of Cuba is a housing crisis, a public services crisis, an electrical crisis, a transportation crisis, a water crisis, a sewage crisis, and so on.

Figure 9. Crumbling Buildings Translate into Housing Shortage



Figure 10. Modes of Transportation in Cuba



Transport remains so chaotic and dysfunctional that even the Cuban authorities admit that it is in crisis. In 1988, according to Cuban official statistics, 3.5 million people used public transportation services in the capital city of Havana, but by the end of 2009 the daily average was barely one million, the rest of the people having to rely on all kinds of private means, old autos, trucks, bicycles, and other unconventional means, or going by foot (see Figure 10). The situation is much worse in the provinces.

INTENSIFYING EFFORTS TO FIND OIL DEPOSITS IN CUBAN WATERS

Cuba has some domestic oil production on-shore and off-shore in shallow waters; Cuba's oil is heavy, better suited for direct burning or for obtaining heavy refined products than for gasoline and light products. Chávez' Venezuela has been providing the island with cheap oil for years, relieving Cuba of paying an almost insurmountable oil import bill. But Cuba would feel more comfortable and secure if it found its own oil. Should a significant oil deposit be found, this could transform the island's economic and political outlook.

Cuba's hope rests with an enormous Chinese-built offshore oil drilling rig, Scarabeo 9 (Figure 11), which has been towed half way around the world to Cuban waters and, since March 2012, has been lumbering along the north coast of the island in search of the oil that experts say lies under the sea in unknown but potentially huge quantities. The authorities claim that offshore oil reserves could reach 20 billion barrels, although extraction would require high technology and be costly. There is already considerable interest on the part of foreign private and state-owned oil companies in investing in Cuba, and an optimistic scenario has Cuba producing 700,000 barrels per day by 2015.

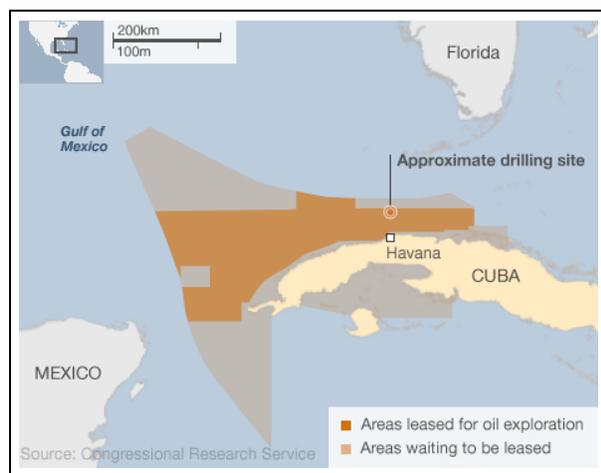
Figure 11. Scarabeo 9 Semi-Submersible Oil Drilling Rig



Disappointingly, the first two wells—drilled on behalf of Spanish oil firm Repsol and Malaysian oil company Petronas, respectively—were not successful in identifying commercially-viable oil deposits. Further exploratory drilling is being conducted by Scarabeo on behalf of international oil companies who have leased blocks of land offshore to drill for oil (Figure 12). While the Cubans would like to lessen Cuba's dependence on Venezuela, the bilateral energy relationship with the Chávez government remains a key factor for Cuba.

SEEKING FOREIGN CREDITS AND INVESTMENTS AND INTENSIFYING EFFORTS TO ACHIEVE THE LIFTING OF THE U.S. EMBARGO

The combination of the international financial crisis and the erosion of Cuba's export capacity in recent years due to policy errors and natural disasters, resulted in a very serious liquidity shortage, which forced the government to further curtail essential imports, devalue the peso, and suspend the servicing of the external debt. It also led to extraordinary measures to protect the liquidity of the Central Bank and other state banks. Among these was the wholesale freezing of hard currency assets deposited in Cuban banks by

Figure 12. Oil Exploration in Cuban Waters

subsidiaries of foreign companies. Other measures included severe rationing of foreign currency to government enterprises, suspension of payments to foreign trade creditors and greater use of barter trade with Venezuela to generate cash flow.

As early as July 2007, Raúl Castro set as a goal an increase of foreign investment in Cuba. But other than continuation of some initiatives already under way—such as attracting Venezuelan investment in the energy sector, Brazil’s financing of the redevelopment of the port of Mariel, and a continued courtship of foreign oil companies to engage in offshore exploration—little new has been done to bring in additional foreign private investment. At the same time, government actions are discouraging foreign partners. Even sales commissions are viewed as corrupt, says Yoani Sánchez, a Havana-based journalist. Foreign companies cannot pay their Cuban employees any more than the standard wage, about \$20 a month, says Sánchez—barely enough for two weeks’ living in poor conditions with a poor diet. Many foreign businesses routinely top up pay with bonuses and commissions, which Havana considers bribery. Thus, the number of foreign joint ventures in Cuba is now no more than 240, according to government insiders, compared to 258 in 2009, the last official figures available; more joint ventures have closed than new ones created since the reform package was approved last April. Among the foreign companies that have departed Cuba are the following:

- Spanish oil giant Repsol quit the country in May 2012.
- Canada’s Pizza Nova, which had six Cuban locations, packed its bags, as did Telecom Italia.
- The country’s largest citrus exporter, BM Group, backed by Israeli investors, has left.
- A Chilean investor who set up one of Cuba’s first joint enterprises, a fruit juice company, fled after being charged with corruption in 2011. He was convicted in absentia.
- Shipping investors are pulling out, even as Cuba prepares to open a new terminal on the island’s north coast.

The need for additional foreign partners is especially acute given the uncertain future of Cuba’s cancer-stricken ally, Venezuelan president Hugo Chávez, who is behind Venezuela’s largesse in providing Cuba with some 115,000 barrels of subsidised oil a day.

Cuban foreign trade is currently concentrated in a small number of countries, with Venezuela leading the way in exports and imports (Figures 13 and 14), which increases its vulnerability to sudden changes in trade relations. This concentration could result in shocks such as those experienced after the collapse of the Soviet bloc, which could be repeated given Cuba’s dependence on Venezuela. Cuba’s economy is currently propped up by Venezuelan trade and aid; one estimate is that Venezuela’s aid amounts to 16–17% of Cuba’s GDP. In addition to Chavez’s health problems and his electoral challenges, the Venezuelan economy is also facing internal troubles. It would be difficult—even if Chávez survived health and electoral challenges—for Venezuela to sustain, let alone increase, its aid.

This explains why Raúl Castro recently made trips to Russia, China, Vietnam, Brazil and Korea, in the hope of stimulating trade, obtaining new credits and encouraging new investments. Those efforts have been directed at countries where negotiations can take place at political rather than commercial levels. Moreover, barter trade has progressively replaced commercial trade; whereas it was only 40% of Cuba’s external trade ten years ago, it is now 60%. This hardly helps macro efficiency.

Figure 13. Cuba's Merchandise Exports by Destination, 2010
(Total Value of Exports: \$4,598 million)

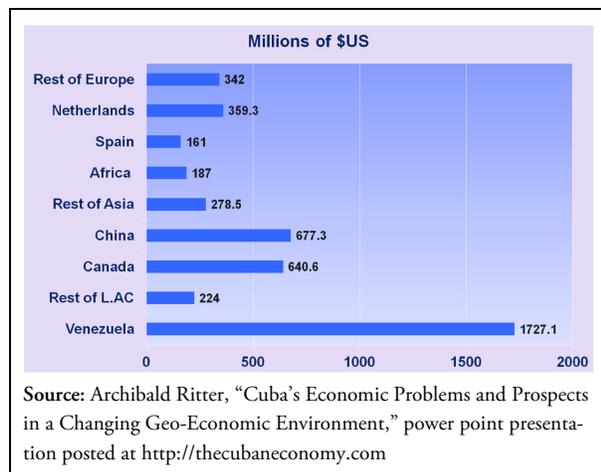
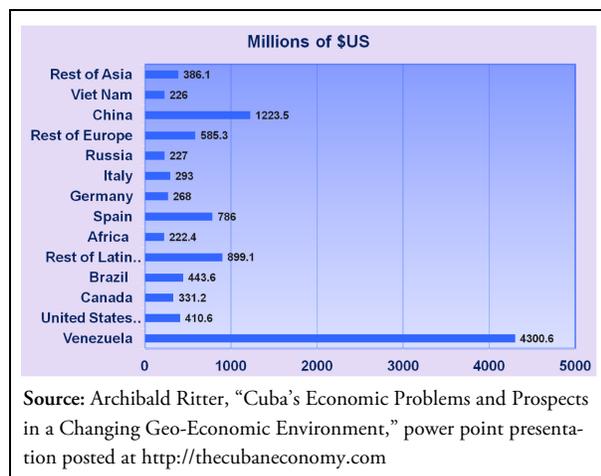


Figure 14. Cuba's Merchandise Imports by Destination, 2010
(Total Value of Imports: \$10,647 million)



Undoubtedly, Cuba's economic future would be much brighter if relations with the United States were normalized. Raúl Castro's government has intensified its efforts promote lifting of the embargo, first by promoting votes in international fora calling for an end to the embargo and second, by intensifying lobbying by various groups within the United States to the same end.

Even with current economic limitations, the United States is Cuba's fifth-largest trade partner and the leading source of agricultural imports. The two most important elements of the embargo that are still in place are access to U.S. financing and the limitations to American tourists to visit Cuba. Were relations with the United States normalized and restrictions dropped, Cuba's economy would receive an enormous lift from investment and trade with the United States, and the tourist industry would likely boom.

Reestablishment of normal relations with the U.S. would also open the door for Cuba to become a member once again of the International Monetary Fund and the World Bank, as well as the Inter-American Development Bank, all important sources of international financing for economic development. Even if the U.S. embargo were to be lifted, for the benefits of such action to materialize, the Cuban government would have to accelerate and deepen reforms, because without them it is impossible to generate export surpluses to pay for imports

An important constraint on Cuba's economic well-being since the 1950s has been its weakness in generating foreign exchange from the export of goods and services. This became painfully clear in the 1961–1970 period and again from 1990 to the present, though the special relationship with the Soviet Union reduced its impact in the 1970s and 1980s. For a small country, foreign exchange earnings constitute the economic foundation for continuing economic and social improvement. It is imperative that Cuba develop such export activities.

From 1990 to 2005, Cuba increased foreign exchange earnings principally through an expansion of tourism, remittances from former Cubans living abroad and growing nickel exports. Exports of sugar, rum, tobacco products, biotechnology products and a few minor exports also contributed. This was supplemented with direct investment in the form of joint venture arrangements and within five export processing zones. Cuba also successfully reduced oil imports through an expansion of domestic oil and gas extraction. Since 2006, Cuba re-oriented its drive to earn and conserve foreign exchange, promoting import substitution and exports of medical and other

services, but these efforts have tended to dampen rather than promote economic growth and development.

While increasing agricultural production and productivity of public enterprises are desirable, the emphasis on import substitution is not. Cuba has in the past depended on the exports of sugar, minerals and tourism as the main foreign exchange earners to be able to meet its import needs. In recent years, the sugar sector had been nearly abandoned and tourism has reached some limits in the absence of new significant investments. The main export earnings producer has been the export of professional services, but this also has limits and does not generate backward linkages on the domestic economic activities. Instead of focusing on import substitution, the authorities should be looking at the promotion of other exports, but this is hampered by the current exchange system and the dual currency as well as by the system of price controls

CONCLUSIONS

Raúl Castro has attempted to address the considerable popular discontent over living conditions on the island by opening up the economy—but only to a very modest degree, given his fear that broad-based economic reforms could be politically destabilizing. If no improvements are achieved, Cubans could demand political change, which Raúl has absolutely no intention of permitting.

There has been some liberalization of the economy, with a small opening to private employment and limited reform in the agriculture sector, the 10-year renewable lease on agricultural land being the most important. There are other major disincentives to enterprise growth: price controls are still in effect, micro-businesses are tightly controlled, with little access to credit and highly taxed. The result is low product diversity, a large underground economy, widespread inefficiency, a low scale of production, wasted resources, contempt for law, corruption, and lack of innovation.

The policies implemented so far are quite timid. Much deeper structural reforms are required to allow the private sector to contribute to the growth of the economy so as to allow the State to concentrate on its

role of providing an appropriate legal and regulatory framework for the activities to flourish instead of trying to micro manage all economic activities.

A priority two years ago was the plan to shed 1 million workers from public payrolls. One hundred eighty-three private trades were approved by the Cuban Communist Party to absorb downsized workers. However, the limitations of private-sector work, inflexible laws, high taxes, the continuation of a dual currency system (pesos and CUCs), and poor conditions to acquire inputs have thwarted these efforts. A recent government report said there were 5 million people employed in 2011, similar to 2009, while unemployment rose from 86,000 to 164,000. Of those working, 391,500 were self-employed in 2011, when the government loosened regulations on small businesses, compared with 147,400 in 2009. More than 170,000 individuals have also taken advantage of a land lease program begun in 2008, the government recently reported. There was some progress reported in trimming the bureaucracy, as the number of “directors” fell from 380,000 in 2009 to 249,000 in 2011.

The dual currency system is an impediment to the success of the reforms. To increase real salaries there has to be a greater offer of products in the same currency in which salaries are paid. Neither of the island’s currencies—the Cuban pesos (CUP) or the Convertible Cuban peso (CUC)—is traded on international exchanges, but Cubans need both to cover the basics. Most salaries are paid in CUP, but Cubans need to pay for basic needs in CUC. Government stores that sell imported goods in CUC typically mark them up 200% or more. Authorities defend the prices as a mechanism to redistribute wealth and hold together the island’s fraying social safety net. But many see the prices abusive, since essential goods are often only available at such stores, leaving the most economically vulnerable residents with no other option.

While there has been some liberalization in agriculture and the labor market and there has been some dismantling of the centralized decision making model, the Cuban economic model is still very close to the one used in the former Soviet Union. Non-State

enterprises are limited to agriculture, a small foreign investment sector and a very limited number of self-employment activities. The State authorities retain the power to dictate the majority of the prices in the economy, as well as an excessive number of regulations of both domestic and international trade. The control over the financial flows and the rate of exchange restrict heavily any entrepreneurial initiative and the legal framework is not clearly defined. The State is still dictating the allocation of resources leaving very little room for individual initiative and the working of appropriate incentives to bring about an improvement in productivity. Despite the efforts to improve the performance of the public sector and to give a greater role to private activity overall domestic economic activity and the well-being of the population continues to decline, there continues to be a decapitalization of the industrial capital stock and it is unlikely that this will improve in the absence of foreign investment.

Much of the disconnect between the announced reforms and their results stems from the timidity of the

reforms. The central challenge facing Cuba is that its policy framework remains an impediment to productivity and growth. Pressure from both external vulnerabilities and increasingly, aging costs and emigration, are adding to this fundamental challenge.

Overall, there has been disappointment that more significant economic reforms have not materialized under Raúl Castro. Reforms such as currency unification, free access to information technology and free foreign travel in support of Cuba's knowledge economy, or a true rationalization of the public sector, seem a long way off. A recent survey indicates that the majority of Cuban has little faith that the reforms adopted will bring about a significant improvement in the economic situation. Despite the liberalization measures, illegal Cuban migration, after years of decline, is up again and unless there is a significant improvement in the standards of living, Cubans will continue to leave the country by whatever means are available.