THE PERFORMANCE OF CUBA'S GROSS DOMESTIC PRODUCT, 2015–16: THE ROLE OF EXTERNAL FACTORS, BUSINESS CONFIDENCE AND DOMESTIC POLICIES

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This article relies on the Cuba Standard Economic Trend Index (CSETI) to analyze Cuba's GDP growth in 2015 and develop projections for 2016. Growth increased from 1% in 2014 to 4.3% in 2015, but it is expected to drop to approximately zero in 2016 and into negative territory in 2017—all below the official target of 4.4%. The strong performance in 2015 reflected a steep rise in tourism and a faster expansion of domestic demand. The sharp slowdown 2016 and the recession in 2017 would result largely from the 20% cutback in oil supplies by Venezuela in July 2016.

The Cuba Standard Business Confidence Index (CSCI) rose sharply in the third quarter of 2015, but fell abruptly in the following two quarters. The negative impact of the U.S. embargo declined during that period, reflecting the recent measures adopted by the Obama administration, although it remained the principal negative factor together with the effect of government bureaucracy.

The paper examines the possibility that strong GDP growth in 2015 may have resulted from expansionary monetary and wage policies. The growth of both government wages and CUP-denominated monetary aggregates surged during 2014 and 2015. However, the latter may have reflected the conversion of assets denominated in "convertible pesos" (CUCs) into non-convertible pesos (CUPs) as a step in the process of exchange rate reform. After several years of restraint, the fiscal position was allowed to deteriorate markedly in 2015.

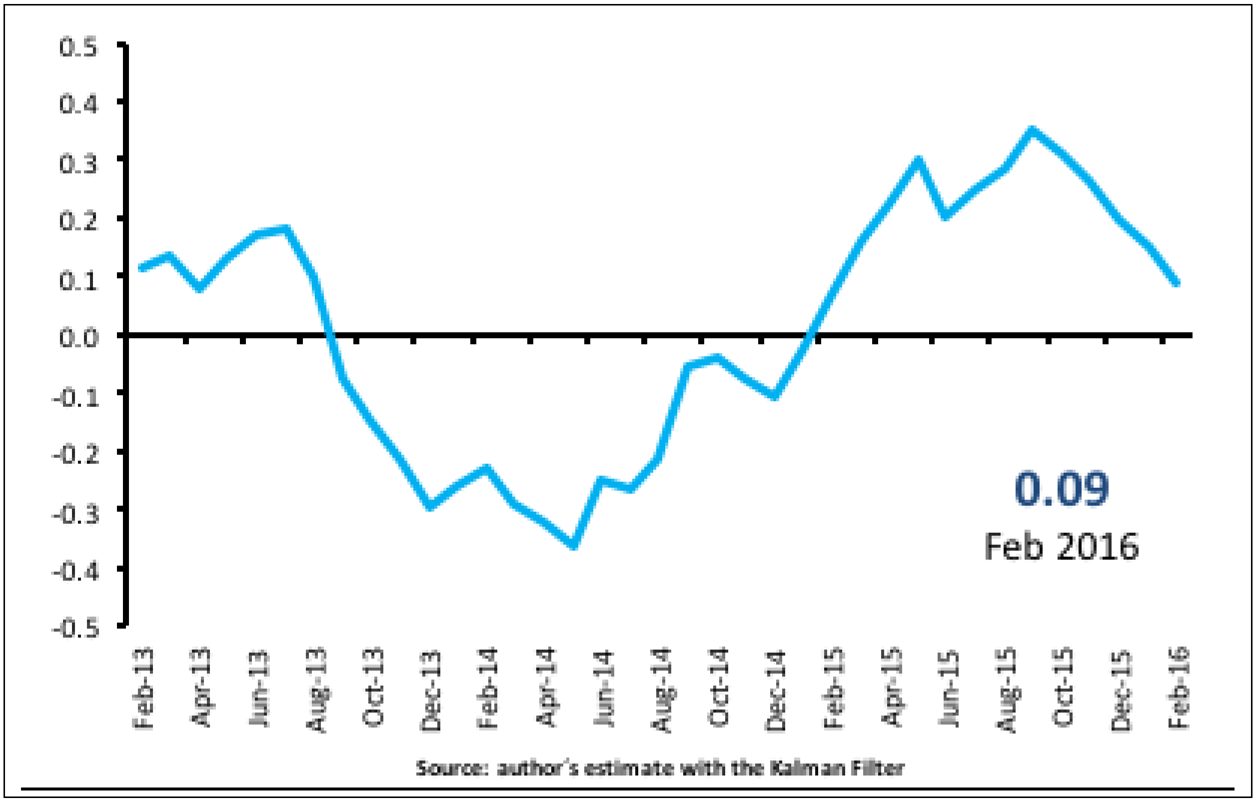
BALANCE OF PAYMENTS CONDITIONS: FAVORABLE IN 2015 BUT TURNING NEGATIVE IN 2016

At the December session of Cuba's National Assembly, Minister of Economy and Planning Marino Murillo Jorge announced that the Cuban economy had grown by 4.3% in 2015, a sharp acceleration compared with only 1% in 2014 and an annual average of 2.7% from 2008 to 2013. Output growth in 2015 remained just below the target rate of 4.4% set by the government of Raúl Castro for the years of economic reform, even though it came closer to that target than in any year since 2008. It also remained far below the two-digit rates achieved during the middle years of the 2000s, when the economy benefited substantially from Cuba's agreements with Venezuela.

With actual data for 2015 and estimates for January and February 2016, the Cuba Standard Economic

1. The authors would like to thank Luis R. Luis for helpful comments on a previous draft.

Figure 1. Cuba Standard Economic Trend Index (CSETI) Feb 2013 - Feb 2016



Trend Index (CSETI)[2] confirms that favorable balance of payments conditions during 2015 contributed to positive economic growth (i.e., the index had a value above zero). The CSETI values for all four quarters of 2015 were much higher than in the corresponding quarters of 2014, which is consistent with the year on year acceleration of GDP growth from 1% in 2014 to 4.3% in 2015.

The CSETI peaked at 0.35 in September 2015, but since then it has shown a negative trend that continued over the first half of 2016. In February 2016, the CSETI reached a 12-month low of just 0.09 and the most recent data indicates that the index continued to fall through mid-year and reached negative territory in June 2016. This suggests that from the fourth quarter of 2015 through mid-2016, balance of payment conditions became unfavorable for the Cuban economy.[3]

In 2015, imports of consumer and capital goods jumped by 40.9% in value, following a drop of 7.2%% in the previous year and an average decline of 3.2% in the period 2009–2013—which is fully con-

2. The CSETI provides an advanced indicator of Cuban GDP growth. The index is composed of 28 monthly variables from January 1998 to the present. It includes information on real exports to and imports from Cuba's 10 leading trading partners (from COMETRADE and the World Bank); on world prices for nickel, sugar, oil and food; and it approximates the dependency on Venezuela by the monthly value of trade in goods between the two countries. The Kalman Filter econometric technique is used to construct the index, which allows the estimation of a common component of the evolution of the 28 variables. The signal contained in the combination of these variables draws together the state of the economy every month. Values above (below) zero indicate favorable (unfavorable) balance of payments conditions for GDP growth.

3. Even though the index aims at providing a smooth trend of economic activity, it still displays considerable volatility because it includes highly volatile commodity prices.

sistent with last year's turnaround in GDP growth[4]. Historically, there is a close relation between imports and GDP in Cuba. For 2015 as a whole, imports from most major trading partners increased at an unusually fast pace: by 77.2% for China, 38.4% for Spain, 42.1% for the Netherlands, 33.9% for Germany, and 45% for Italy. These were offset only in part by lower imports from the United States (39.7%), from France (2.3%) and Mexico (1.6%). The upward trend in imports has been reversed in the first half of 2016.

Exports of goods fell by 24.2% in 2015. At this point there is no information on commodity composition of exports, but it probably represented in large measure the impact of 2015 plunge in the price of oil on Cuban exports of refined petroleum products. Cuba's merchandise trade deficit widened to $9.6 billion in 2015 from $7.9 billion in 2014, in spite of the huge impact on the value of fuel imports of the collapse in oil prices. However, revenue from tourism, increased by 10.7% (from $2,546 million in 2014 to $2,819 million in 2015) following two years of negative growth. Tourist arrivals surged by 17% in 2015; arrivals from the United States jumped by a record 77% while those from Mexico, Germany, France, and England each rose by more than 25%. Arrivals from the "Cuban community abroad" increased by 8%. Meanwhile, Cuba's international terms of trade fluctuated without a pronounced trend during 2015. An evaluation of the current account of the balance of payments in 2015 will have to await information on interest payments, current transfers (including remittances) and non-tourist services. But the current account balance probably deteriorated in 2015 after several years of hefty surpluses.

According to the National Office of Statistics and Information (ONEI), domestic investment increased by 24.9% in 2015, providing yet another indication of the strength of domestic demand. Construction and assembly rose by 16.7% and investment in equipment by 54.4%. By province, investment in Havana (3.1 billion pesos) topped the list. Artemisa came in second place at 424 million pesos, suggesting that the startup of the Mariel Special Development Zone (ZED Mariel) made a significant contribution. Investment was also strong in the eastern provinces of Holguín (372 million) and Santiago de Cuba (316 million).

In January and February of 2016 the prices of key export products again started to decline; the price of sugar was down 9.4% from the end of December 2014, and the price of nickel by 4.7%. Since then, however, both prices have moved up. The international average of food prices (Cuba is a net importer of food) increased by 0.7%, according to World Bank data.

Owing largely to the 20% cut in shipments of Venezuelan oil announced in July, our projection for GDP growth in 2016 has been revised downward to near zero, compared to our earlier projection of 2.3% and a previous government forecast of 2.9%. President Raúl Castro and Minister Murillo Jorge have recognized publicly that difficult days lie ahead for the Cuban economy, and the oil refinery in Cienfuegos, which uses Venezuelan crude oil, has already reduced its output. Against this background, but assuming no further cuts in oil supplies from Venezuela, we expect the Cuban economy to show negative growth of 2.7% in 2017, when the impact of the July 2016 cut in oil imports will be felt in full. As the year progresses and the CSETI benefits from more recent data, it will be possible to estimate more exactly the effects of the ongoing Venezuelan crisis and other events on the balance of payments and the economy of Cuba.

The future of relations with Venezuela constitutes a major element of uncertainty in any forecast of the Cuban economy. To cope with this uncertainty, the Cuban authorities have sought to diversify sources of foreign-exchange revenue. The drop in the oil price in itself has reduced the value of commercial transactions with Venezuela. Moreover, Cuba has been trying to diversify its exports of professional services by

4. The value of *total* merchandise imports rose by only 2.9% in 2015, but this was because imports of intermediate goods (which consist mainly of petroleum) dropped by 9.1%, reflecting the collapse in the price of oil.

sending medical personnel to countries other than Venezuela, notably Brazil. Also, revenue from tourism increased strongly in 2015, turning the sector again into a driving force of domestic economic activity and providing an alternative source of foreign exchange. Inflows from remittances of Cubans residing abroad also have continued to increase rapidly.

While diversification efforts have had some success, the economic and political future of Venezuela continues to be a high-risk factor for the development of the Cuban economy: in 2014 the commercial transactions between the two countries totaled 18% of Cuba's GDP.[5] This total involves some double counting, however, because the oil used in the Cienfuegos refinery and re-exported is already included in Cuban oil imports, and because imports of Venezuelan oil is effectively bartered against Cuban exports of professional services. Taking these factors into account the impact of a complete cancelation of the Cuba-Venezuela Accord could be about 11% of Cuban GDP, even assuming no multiplier effects. The most complicated aspect of Cuba's relations with Venezuela is that — as in the case of relations with the USSR before 1990 — they involve trade and financial links that are difficult to replace in other markets because they are very specific in nature and result from political alliances between governments.

Venezuelan oil is indispensable to maintain electric power generation in Cuba and production at the Cienfuegos refinery (a Cuban-Venezuelan joint venture). On the other side of the coin are the medical and other professional services Cuba provides to Venezuela, by far the Cuba's largest source of hard-currency income. All of these transactions are made at payment conditions that Cuba could not duplicate in other markets. If the Accord with Venezuela is rescinded, or substantially cut down, the Cuban economy will undoubtedly enter a period of recession whose duration and magnitude will depend on the quality and speed of the Cuban government's reaction. The new international possibilities that have opened up since December 17, 2014, with the normalization process between the United States and Cuba, could help to soften the blow. But the extent of the relief will depend mostly on the capacity and willingness of Cuba's policy makers to take advantage of the new opportunities opening up in international markets, and until now the response has been very slow.

BUSINESS CONFIDENCE DROPS IN 2016

In Figure 2 we present the results of the Cuba Standard Business Confidence Index (CSCI)[6] for the first quarter 2016 (it measures the average difference between the percentages of positive and negative responses, respectively, to each question in the Business Confidence Survey). The respondents include Cuban state enterprises as well as foreign companies. The index ranges between 0%, when all responses are negative, to 100% when all responses are positive.

The CSCI surged in the third quarter of 2015, but it fell sharply in the first quarter of 2016, for the second consecutive quarter. This indicates a deterioration of perceptions and expectations about the Cuban economy. The score of 57.2 for the first quarter of 2016is the lowest since measurements with this index began (see Figure 2).

It should be noted that both the index that measures balance-of-payment conditions and GDP (CSETI in

5. This is calculated as the sum of Cuban merchandise imports from Venezuela (7.3% of GDP), Cuban merchandise exports to Venezuela (3% of GDP), and an estimate of Cuban professional services to that country (7.8% of GDP). Both imports and exports of goods consist primarily of oil and products. The value of Cuban transactions with Venezuela probably fell sharply in 2015 because of the plunge in the price of oil.

6. The CSCI estimates of the business climate are based on qualitative information collected through a survey consisting of eight questions (see Pavel Vidal, https://www.cubastandard.com/?page_id=12796). The design of the survey is based on international standards presented in the 2003 OECD document titled *Business Tendency Surveys: A Handbook*. The survey is conducted quarterly via e-mail to a random sample of around 100 businesspeople connected to the Cuban economy. The results allow the construction of a confidence or economic optimism index. CSEI is calculated as the difference between the percentage of positive and negative responses to each question, which are then averaged out. The index is constrained to fall within a range between 0 and 100%. It would have a value of 100 if all answers were positive, and of zero if all answers were negative.

Figure 2. Cuba Standard Business Confidence Index (CSCI) 2015-2016Q1

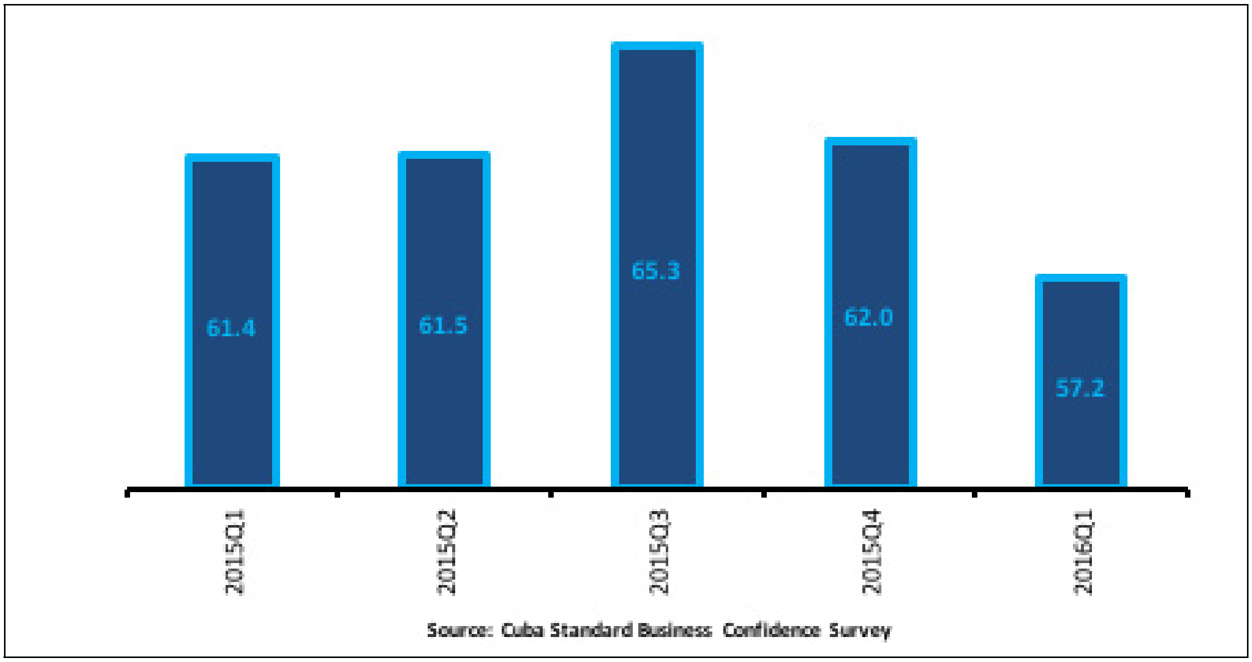


Figure 1) and the business confidence index (CSCI in Figure 2) peaked in the third quarter of 2015 but have declined continuously since then. These two signals point to a considerable deterioration of the economic situation in Cuba from the fourth quarter 2015 to the first quarter 2016.

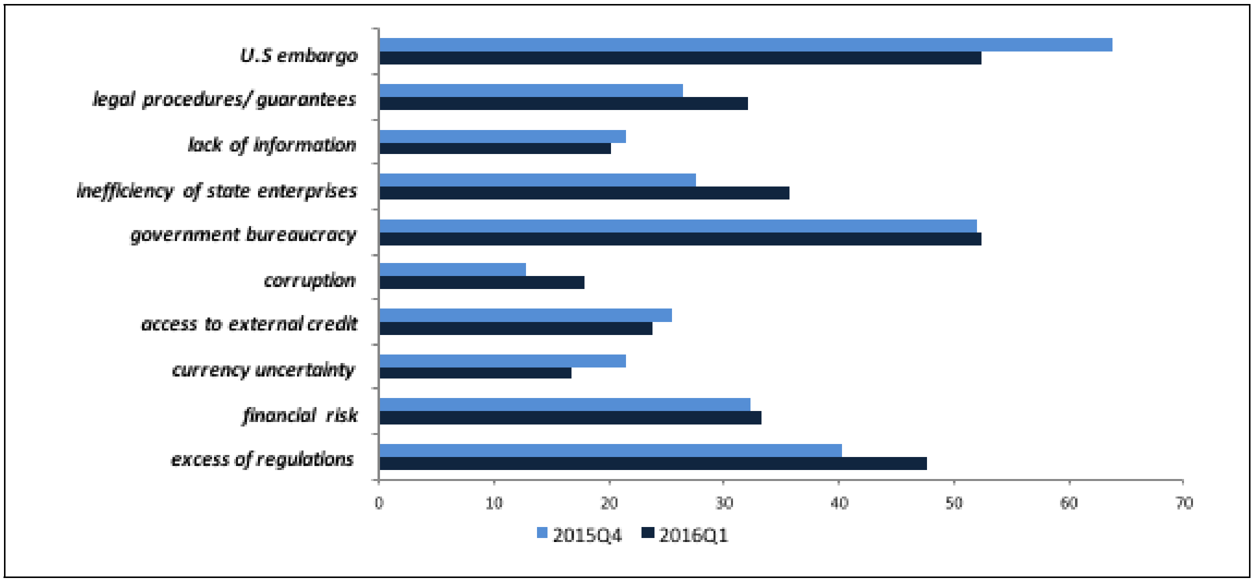
The drop in business confidence in the first quarter of this year can be seen in the responses to all of the survey questions. Only 25.6% of respondents reported their business volume had increased, compared to 40.4% in the previous quarter. Meanwhile, 34.9% said they expected an improvement in business volume for the next four months, down from 43.5% in the previous quarter. As regards their financial situation, only 20.5% of the respondents said it was good—a decline from 23.5% of the previous quarter. And 60.5% believed that the economy would improve over the next 12 months, down from 62.9% in the previous quarter.

As for investment intentions, recent data show another significant drop. In the third quarter of 2015, 45.3% of businesspeople indicated a rise in their intentions to invest in Cuba, but the percentage declined to 37.6% in the fourth quarter 2015, and to 28.8% in the first quarter 2016. This confirms anecdotal evidence about the frustration of many investors when they realize that the obstacles to investing in Cuba are higher than they had imagined. Today, the restrictions imposed by the U.S. government and those enforced by the Cuban government constitute the main barriers to business expansion and the attraction of new investment to the island. In both cases, politics play a more important role than economic considerations.

The last question of the Business Confidence Survey — *What factors are limiting your ability to increase/develop business activity in/with Cuba?* — provides additional information (see Figure 3). Compared to the last quarter of 2015, the U.S. embargo was cited by fewer respondents, although it continues to be the top obstacle. It now shares the No. 1 spot with Cuban government bureaucracy, with 52.4% of respondents selecting both factors. The largest increase in this quarter was the inefficiency of state companies (from 27.5% to 35.7%), followed by excessive regulation (from 40.2% to 47.6%), legal proceedings and guarantees (from 26.5% to 32.1%), and corruption (from 12.7% to 17.9%).

The survey results reflect the effects of the measures recently introduced by the U.S. government that eased some of the economic sanctions imposed on Cuba, although it does not eliminate the main re-

Figure 3. What factors are limiting your ability to increase/develop business activity in/with Cuba? Please check the most important factors (five at most)



strictions against trade, finance and investment. At the same time, the respondents continue to point to excessive regulations and bureaucracy in Cuba as major obstacles to a genuine liberalization and to the international opening of the Cuban economy.

THE ROLE OF MACROECONOMIC POLICIES

The first section of this paper argued that external factors, notably tourism, helped to explain the rebound of economic growth in 2015, while changes in world commodity prices on balance had little effect. At the same time, several indicators, including the rapid growth of consumer and capital goods imports, suggests that domestic demand in Cuba had strengthened considerably. A more informed judgment will have to await the publication by ONEI of complete national accounts data for 2015 and, hopefully, some balance of payments data after 2012—the last year for which complete current account data have been published. However, several partial indicators, including the rapid increases in investment and production of construction materials and intermediate goods, confirm that domestic demand bounced back strongly in 2015 after several years of slow gro. This section examines the extent to which a relaxation of macro-economic policies may have contributed to this rebound.

Table 1. Cuba: Selected Policy Indicators

	Percentage changes at annual rates[ab]			
	2008	**2009–13**	**2014**	**2015**
Monetary aggregates				
M0 Currency	8.4	4.3	23.0	12.1
M1A M0 + demand deposits	9.1	6.4	23.2	…
M2A M1A + time deposits	15.6	5.0	21.1	9.3
Fiscal position (% of GDP)				
Overall deficit (-)	-6.9	-3.0	-2.2	-5.7
Capital formation	8.1	5.6	2.6	3.0
Current surplus[c]	0.1	2.5	0.3	-1.8
Public sector wages	1.7	2.5	36.6	16.2
Imports[d] (% of GDP)	7.3	4.2	3.9	8.3

Source: ONEI and authors' calculations

a. Unless otherwise noted
b. Includes only assets denominated in non-convertible pesos (CUPs)
c. Excludes capital investment
d. Consumer and capital goods

A little history can provide some perspective. In 2008–09 the Cuban economy was affected by a severe crisis resulting from: (i) overheating caused by a highly expansionary fiscal policy coupled with large-scale Venezuelan-financed investments; (ii) plummeting nickel prices; and (iii) several destructive tropical hurricanes. These developments resulted in unusually large fiscal and current account deficits as well as a domestic liquidity crisis and severe external payments difficulties.

From 2009 through 2013, the new administration led by Raúl Castro sought to stabilize the economy by implementing restrained fiscal, monetary and wage policies and intensifying administrative controls on imports. Table 1 shows that, over this period, rates of monetary expansion were substantially reduced, the fiscal deficit was slashed, and wage increases in the public sector were kept very low. As a result, real GDP growth slowed to an annual average of 2.4%, compared with 4% in 2008 and an annual average of 5% during the first decade of the XXI century. The economy was stabilized and payments arrears were settled with major suppliers. There was a significant improvement in the climate for Cuba in world financial markets, as evidenced by the debt rescheduling agreements with Russia, Mexico and other countries, and the beginning of talks with the Paris Club. Finally, the ratio of imports of consumer and capital goods to GDP suggests that import controls were tightened considerably.

There are indications that macroeconomic policies took a turn towards expansion in 2014–15. First, as indicated in Table 1, there was a surge in the growth of all aggregates denominated in non-convertible pesos (CUPs).[7] Second, wage growth exploded in the public sector. Third, fiscal policy apparently remained restrained in 2014, but the budget deficit was allowed to balloon in 2015. Apparently the period of restrained macroeconomic policy had ended.

Monetary Policy

The huge increase in the CUP-denominated aggregates in 2014–15 could help to explain the rapid growth of GDP in 2015 (monetary policy has been shown to affect economic activity with a lag). The CUP denominated money supply growth slowed considerably in 2015 but remained very high by historical standards. That being said, these changes must be interpreted with considerable caution. Indeed, there are two reasons to doubt whether the surge in the CUP-denominated money supply in 2014–15 truly reflected a change in the stance of monetary policy. First, ONEI publishes only monetary aggregates denominated in non-convertible pesos (CUPs); aggregates denominated in convertible pesos (CUPs) are kept secret. Therefore, the total value of money outstanding is unknown. Second, the (published) monetary expansion in those years was much larger than the government's financing requirement.

The issue can be examined by looking at a simplified balance sheet of the banking system, which encompasses the Central Bank of Cuba and the commercial banks. We assume that the liabilities of the system consist of all items included in the definition of M2A (i.e., currency plus saving and time deposits denominated in *both* CUPs and CUCs). The asset side of the balance sheet includes net domestic credit (to both government and enterprises) and net foreign assets.

M2A = Credit to government + credit to enterprises + net foreign assets

Breaking down M2A into its two components (p=CUP, c=CUC), assuming that the government deficit is fully financed by credit from the banking system yields[8]:

$$\Delta M2A(p) \text{ - Fiscal deficit} + \Delta\text{Credit to enterprises} + \Delta \text{ Net foreign assets} - \Delta M2A(c)$$

[10.40] [6.59] [....] [-0.50] [….]

7. There is no published information on aggregates denominated in convertible pesos (CUCs).

8. In advanced countries the government's financing requirement is normally satisfied through central bank credit or through borrowing in financial markets. In Cuba's case, however, there is no bond market and therefore no way to borrow directly from domestic non-bank residents. The commercial banks are subject to government control and are known to participate in the financing of the state deficit. Thus the broad aggregate M2-A is believed to be a more appropriate concept than the monetary base or currency.

Figures in square brackets are actual numbers for the two-year period 2014–15 in billions of pesos, and the dots indicate that data is not available. The change in net foreign assets is approximated by the change in Cuban net claims on BIS-reporting countries, which is an incomplete indicator because it does not include claims on certain countries like China. This last equation indicates that there are three possible explanations for the financing puzzle.

1. Domestic credit expansion to the government (alias the fiscal deficit) was less than the published increase in the money supply because part of the monetary expansion financed lending to enterprises (public or private). In all probability, this cannot explain the magnitude of the increase in money.
2. The published rise in the money supply was absorbed by an accumulation of net foreign assets. This cannot be verified because ONEI does not publish data on official foreign assets. The changes in BIS-reported Cuban net claims suggest that the opposite may have happened.
3. Part of the surge in the CUP money supply represented government purchases of convertible pesos, in which case the rise in the *total* money supply may have been smaller than what appears in Table 1. The government may have sought to retire CUCs from circulation as part of the ongoing monetary/exchange rate reform.[9] We do not know at what (CUP/CUC) exchange rate the conversion may have occurred.

Unfortunately, all three explanations are unverifiable because the Central Bank of Cuba does not publish the balance sheet of the Cuban banking system (and not even its own balance sheet). In particular, there is no published information on official international reserves; and not even a mention of assets and liabilities denominated in convertible pesos. There are too many unknowns in the equations and therefore any evaluation of changes in Cuba's *total* money supply is hostage to fortune.

A definitive judgment on the role of policies in 2014–15 will have to await additional information by ONEI, and an end to the government secrecy concerning assets denominated in convertible pesos. To the extent that the surge in CUP-denominated money reflected the retirement of CUC-denominated assets, this would augur well for the ongoing reform of Cuba's exchange system which requires the abolition of the dual exchange rate system through the elimination of the "convertible" peso. It would also mean that the role of expansionary policies in explaining growth in 2015 was not as important as suggested by the published monetary data.

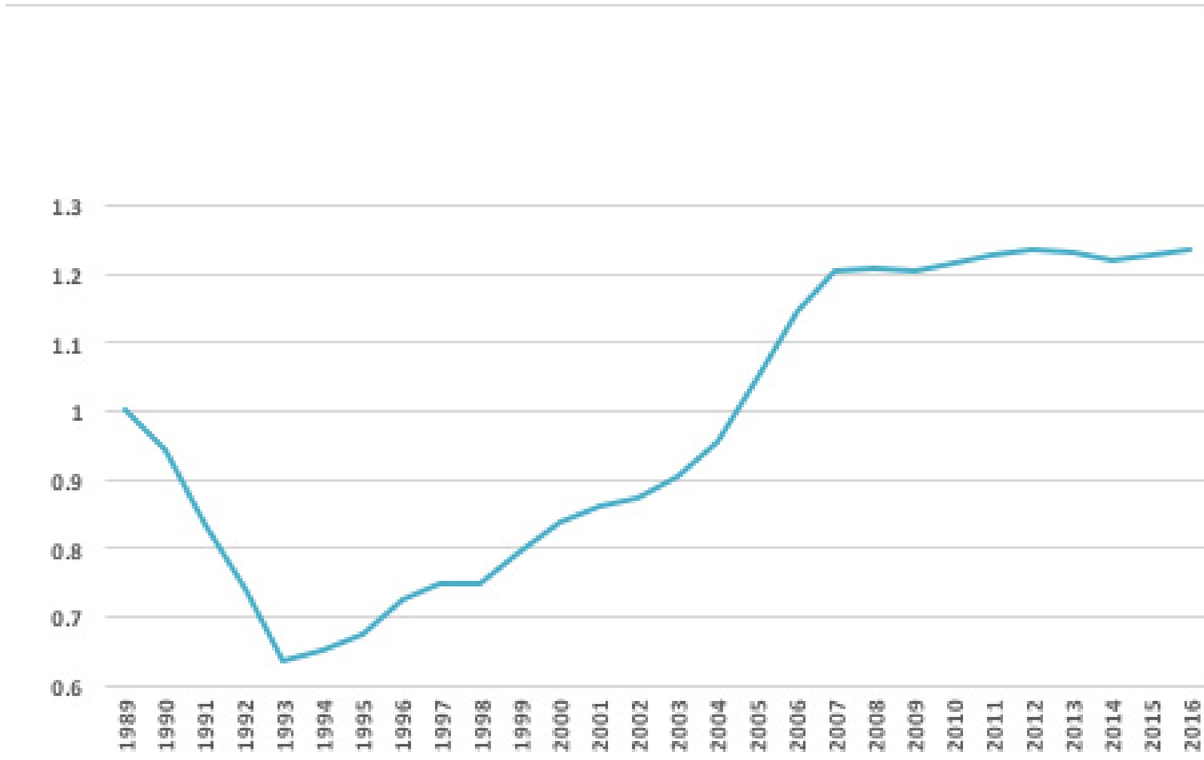
Wage Policy

Wage growth in the public sector surged in 2014; it slowed significantly in 2015 but remained well above the average for the period 2009–13. The increase in wages in 2014–15 was very large, and so was its impact on the fiscal position. It did, however, have some justification. First it raised the very low incomes of public employees and is therefore likely to improve work effort and productivity. Second, it came at a time when *private* earnings appear to be increasing rapidly, and shortages of skilled labor have been observed in the state sector (there is anecdotal evidence that medical personnel, teachers and public accountants sometimes migrated to private jobs like cab driving or farming). Third, the recent wage boost comes after a long period of considerable reduction in disguised unemployment. Therefore it rewarded mostly *active* government workers. Fourth, because state employment has been substantially reduced since 2011, the recent increase in wages applies to smaller base than it otherwise would. And finally, the wage increase should help to reduce the number of discouraged workers, which appears to have increased rapidly in recent years.[10]

9. This third possibility was suggested to us by Luis R. Luis.

10. It is possible, however, that many of those who left the officially measured labor force did not retire permanently, but rather joined the unofficial economy (according to some estimates the number of unregistered self-employed reached 450 thousand in 2015, or 9% of the officially reported labor force).

Figure 4. Cuba: Gap Between Actual and Potential GDP (1989=1)



Note: The method used to estimate potential GDP is explained in Hernández-Catá's paper "Why has the Cuban Economy Grown so Fast since the mid-1990's," presented at the Annual Meeting of the American Economic Association, San Francisco, January 2016.

To summarize, the increase in wages in 2014–15 probably will have some positive short-run effects. But it can definitely not be sustained over the medium to long-term without fundamental changes in other policies. This is clear from the history of labor market developments in Cuba. From the end of the post-Soviet period in 1994 to the crisis of 2008, Cuba was successful in reducing disguised unemployment in the public sector, a reduction that accelerated sharply with the large scale transfer of employees from the state to the private sector since 2011. This increased *active* employment substantially and allowed the economy to grow at a rapid pace. At the same time, it resulted in a sharp increase in the degree of labor utilization, as the population of working age generally has been rising very slowly, eventually contributing to overheating and to the crisis of 2008.

The restrained policies adopted in 2009–13 succeeded in relieving the pressure on unused resources (see Figure 4), and therefore on the external position. Concern about overheating re-surfaced in 2015 but it has taken a back seat in view of the recession that looms ahead. Over the long term, however, growth at the government target rate of 4.4% per annum will be unsustainable in the absence of strong measures to increase labor productivity and potential output.

Fiscal Policy

The overall budget deficit fell to 2.2% of GDP in 2014, below the average of the previous five years, and well below the peak reached in 2008. However, the current budget surplus,[11] which had averaged 2.5% of GDP in 2009–13 almost vanished. Fiscal restraint was abandoned in 2015 as the fiscal deficit doubled to 5.7% of GDP, approaching the 2008

11. The current surplus excludes capital formation from government expenditure and serves as a proxy for the change in government net worth.

peak. And the current fiscal balance, traditionally in surplus, shifted into deficit. Was fiscal restrained abandoned?

The period of austerity in 2009–13 was unquestionably necessary to restore macro-stability and avoid a further increase in external arrears. Government current deficits absorb saving that could otherwise be used to increase the capital stock and potential GDP by making room for investment by both private and state enterprises. Yet the post 2008 austerity definitely involved sacrifices. In particular, expenditure restraint at the central government level was substantial, and social spending in particular was severely curtailed. This must have caused displeasure in certain sectors of the population as well as the Party, for economic as well as ideological reasons. More generally, even those concerned with stabilization may have come to the conclusion that austerity had gone far enough and that it was now necessary to provide some support to aggregate demand. The question is how much was desirable and prudent, and in what form.

If stimulus was needed, the emphasis on monetary expansion is less dangerous, because it can be reversed with less difficulty—although it does carry inflationary risks if maintained for too long. Unfortunately the data for 2015 do show a worrisome deterioration in the fiscal position. Unless it is promptly corrected, this deterioration could re-create the conditions that led to the financial crisis of 2008.

CONCLUSION

In conclusion, macroeconomic policies were substantially relaxed in 2014–15, although the extent to which an expansionary monetary policy was indeed implemented is uncertain. If it was, it would have helped to soften some of the recessionary effects associated with the reduction in oil imports from Venezuela and the associated decline in exports of professional services and refined oil products. The same can be said about the recent increase in the fiscal deficit. However, it is clear from the experience of the early 1990s that expansionary policies in themselves will not resolve the problems caused by a massive cut in external assistance—it will, in fact make things worse. If the Venezuelan crisis leads to a further erosion of the oil-for-doctors' agreement, Cuba will have to rely on supply-side policies that increase the role of the private sector, remove the distortions that stifle economic activity (including the system of multiple, overvalued exchange rates), and encourage investment, foreign and domestic.