

The Cuban Economy: The Current Crisis, Its Causes, and Policies for the Future

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BRIEFINGS ON CUBA

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Foreword

CasaCuba, the Cuban Research Institute (CRI), and the Kimberly Green Latin American and Caribbean Center (LACC) at Florida International University (FIU) have joined forces to launch *Briefings on Cuba*. This new series will regularly commission analyses of Cuban politics, economy, culture, and society, and consequent policy recommendations, by top Cuba experts. The *Briefings* will be disseminated widely through the web, social media, and email, with the support of existing communications platforms at CasaCuba, CRI, LACC, and other FIU departments. Each *Briefing* will also be presented before a live audience at events free and open to the public, featuring a presentation by the author, followed by a question-and-answer session. The author will also participate in smaller executive roundtables.

We are pleased to inaugurate our *Briefings on Cuba* with a sobering, well-documented, and up-to-date analysis of the Cuban economy by the prominent Cuban-American scholar, Dr. Carmelo Mesa-Lago. We look forward to presenting and discussing the work of other leading academics and policymakers in this series.

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About the Author

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He was selected among the 50 most influential Ibero-American intellectuals in 2014, and nominated to the SSRC Albert O. Hirschman Prize in Social Sciences in 2020. He is a member of the Community Advisory Board of FIU's Cuban Research Institute.



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— Dr. Carmelo Mesa-Lago

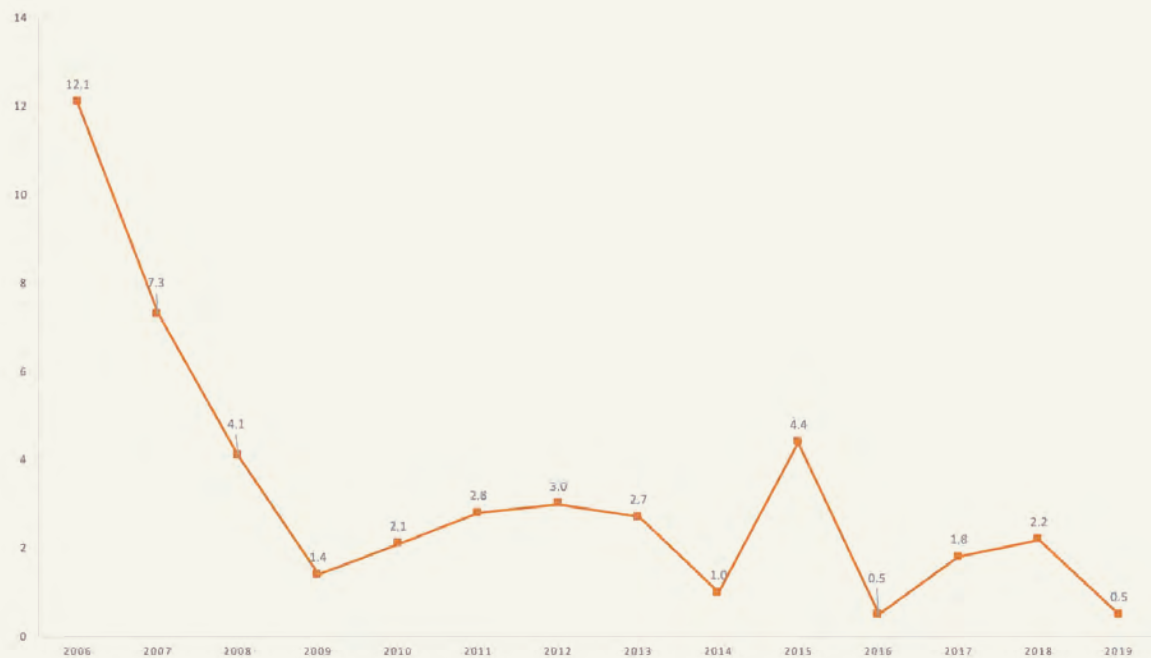
CUBA IS CURRENTLY FACING THE WORST ECONOMIC CRISIS SINCE THE ONE IN THE 1990S FOLLOWING THE COLLAPSE OF THE SOVIET UNION. THIS PAPER EVALUATES THE ECONOMIC SITUATION, ANALYZES THE THREE MAJOR CAUSES OF THE CRISIS, AND EXAMINES THE CUBAN GOVERNMENT'S STRATEGY AND RECOMMENDATIONS OF CUBAN ECONOMISTS AND MY OWN TO IMPROVE THE SITUATION.¹

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Assessment of the Cuban Economic Situation

Gross Domestic Product (GDP) growth at constant prices peaked in Cuba at 12.3% in 2006 (when Raúl Castro took power as provisional president) and fell to 0.5% in 2019 (Figure 1); the annual average growth in the last four years was 1.2%; planned growth for 2020 is 1% but the Economic Commission for Latin America and the Caribbean (ECLAC) projects it at 0.5%; the official target for sustainable economic development is 5%–7%, four to six times the actual average growth.

FIGURE 1. GDP GROWTH IN CUBA, 2006-2019



¹ This paper integrates, restructures, summarizes, and updates several of my recent works on Cuba cited in the reference section; unless specified, sources come from those works; statistics are from ONEI, 2007 to 2019, 2020, and CEPAL, 2019a, 2019b for regional comparisons.

Cuba's gross fixed capital formation (national savings essential for economic growth), averaged 9.7% annually in the last five years, whereas 25% is officially required for adequate growth; said 25% was achieved in 1989 (on the eve of the 1990s crisis) and it has not been reached since then. In the last five years, capital formation in Latin America and the Caribbean averaged 18.6%, twice the Cuban figure.

Cuba's fiscal deficit rose from 1.3% of GDP to 8% in 2013–2018; the 2018 figure is four times the annual regional average of 2.2%. Inflation was 0.6% in 2017 but rose to 2.4% in 2018 (still lower than the regional average of 3.2%), although Cuba's Consumer Price Index (CPI) is unreliable: it excludes prices in the local convertible currency (CUC, see section 2-1) used by the population to buy many consumer goods at state shops, and the monetary liquidity in the hands of the population (circulating cash plus bank savings) doubled in 2007–2018 and, as a percentage of GDP, jumped from 34.1% to 58.9%, evidence of growing inflation.

In 2007–2017, agricultural output rates at constant prices shrank from 7.3% to -1.5%. Production of 13 key agricultural, cattle, and fish products in 2018 was below their peak reached in 2007–2018 in eleven products, and for seven products, the 2018 output level was below 1989. As a result, agricultural exports declined 48% since 2012; Cuba imported \$1.9 billion in agricultural products in 2018, 60% of which could be produced domestically.

The index of industrial production in 2018 was one-third below the level of 1989 (82% below in sugar) due to industry de-capitalization. Annual mining output rates averaged -2.3% in 2013–2018. Out of eleven key mining-manufacturing products, output dwindled for ten compared with their peaks and, in 2018, output of five products was below 1989.

Cuba's best performance has been in international tourism, the third source of hard currency after the export of professional services and remittances. Tourism accelerated in 2015–2016 under Obama's presidency, which facilitated visits, flights, and cruises. Gross tourism revenue (without subtracting the value of imports) peaked at \$3.2 billion in 2018, but net revenue (subtracting 60% of imports) was \$1.3 billion, only 1.2% of GDP. In the last quarter of 2017 and first half of 2018, Cuba received 208,296 fewer tourists because of damage caused by hurricane Irma and President Trump's increasing economic sanctions. U.S. cruise tourists accounted for 53% of total arrivals in the first half of 2019 but fell to 20% after Trump's suspension of cruises. In 2019, Cuba received 9.3% fewer tourists than in 2018; the 2019 target of five million tourists was unfulfilled by 15%.

Annual foreign remittances in cash, mostly sent from the USA, were \$3.7 billion in 2018 and the second source of hard currency.

Due to the Island's poor domestic economic performance, throughout the revolution Cuba has endured a systematic deficit in the trade balance of goods. In 2018, exports of goods were 49% below their 1989 level, whereas imports were above by 41% and the balance of goods deficit grew 220%.

In 2019 Cuba didn't pay \$80 million of its restructured debt with the Paris Club, which condoned \$8.5 billion and left only \$2.6 billion to pay with interest forgiven in 2015–2020 and only 1.5% thereafter (some of the repayments were invested in Cuba); so 9% interest will be charged until payment (Frank, 2020).



Causes of the Current Situation

These are the main causes of the Cuban economic crisis, the first internal and the other two external: (1) the persistence of an inefficient economic model of predominant central planning and state enterprises over the market and private property; (2) the significant decrease in Venezuela's economic aid to Cuba after 2012; and (3) the sanctions imposed by President Trump in 2017-2020, strengthening the U.S. embargo.

1. The Economic Model

Raúl Castro's structural reforms in 2007-2017, oriented towards the market, tried to "update" the central-planning model that has failed all over the world. The state sector was reduced from 84% to 65% of the labor force by dismissing unneeded state employees through the expansion of the non-state sector, which includes private micro-business (self-employment); idle-state land distributed in usufruct (the state retains land ownership and grants small plots to farmers and coops, which keep part of production but must sell the largest part to the state at prices set by the government below the market price—*acopio*); and new non-agricultural production and service cooperatives (NASC). Free buying-selling of dwellings was reauthorized; "gratuities" and social-services costs were reduced, and taxes were reformed.

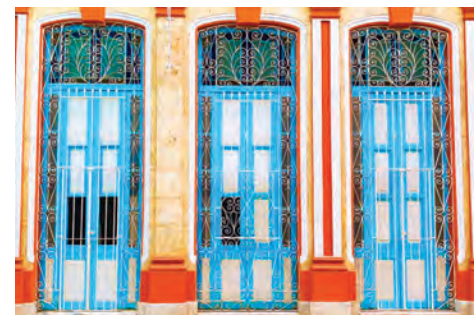
Cuba has two currencies in circulation: the national peso (CUP) and the "convertible" peso (CUC) fixed by the government and not traded internationally (the CUC value is now

similar to the U.S. dollar and equals 24 CUP). Such a duality creates severe distortions (e.g., it impedes determining which exports are profitable, and the population is paid in CUP but must buy many goods-services in CUC). Since the Cuban Communist Party congress in 2011, monetary unification has been a key goal, but duality continues despite much discussion. Other reforms were too slow, tightly regulated, and hindered by many restrictions, taxes, and policy zigzags.

The successful Chinese-Vietnamese model of "market socialism" was discarded. Due to these flaws, the reforms were unsuccessful to improve the economy (e.g., usufruct failed to increase agricultural output). President Miguel Díaz-Canel and the new Constitution have vowed to continue previous policies (*continuismo*).

2. The Impact of Venezuela's Aid Reduction

A constant in the 60 years of the revolution has been heavy dependence on a foreign nation, first the USSR (\$65 billion in 1960-1990, thrice the amount that the Alliance for Progress granted to Latin America) and later Venezuela (\$122 billion in 2007-2017 alone, excluding direct investment). Despite such huge external economic support, Cuba has been unable to restructure its economy to finance imports with its own exports and without foreign aid and subsidies.



Starting in the 2000s, Cuba began exporting professional services (mostly in health care and the first source of hard-currency revenue) and Venezuela bought 75% of them. As a result, a surplus in the balance of services was obtained, which not only offsets the balance of goods deficit, but generated a surplus in the total trade balance that peaked in 2014. Due to Venezuela's severe economic crisis, said surplus halved in 2014-2018, whereas professional exports dropped by 22%; both are important causes of Cuba's GDP decline.

Bolivia, Brazil, and Ecuador recently ended contracts of 9,624 Cuban physicians, an annual loss of about \$1 billion, and some African countries have revoked their contracts. Still professional services, mainly from Venezuela, remain Cuba's first source of foreign revenue.

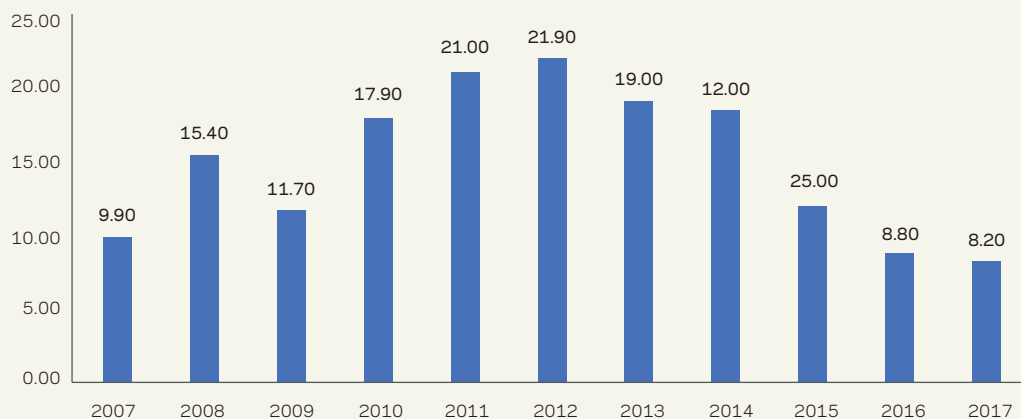
At its peak in 2012, Venezuela exported 105,000 oil barrels per day (b/d) to Cuba, but the figure dropped to 40,000 b/d in January-May 2019. Furthermore, Cuban crude oil production decreased 17% in 2010-2017. Both reductions have provoked an oil deficit of about 65,000 b/d in Cuba, forcing a program of austerity and cuts in energy supply for state agencies and enterprises.

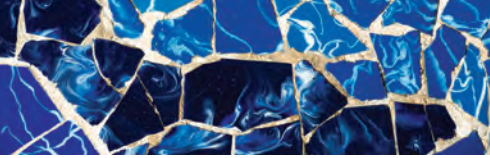
Cuba financed the import of Venezuelan oil with the export of professional services, but their prices were inflated (the Cuban state was paid for one of its doctors seven times the average salary of Venezuelan doctors), so there was a significant hidden subsidy. A substantial amount of Venezuelan crude oil was processed at the refinery in Cienfuegos, Cuba; part of the refined oil was sent back to Venezuela, but Cuba exported a surplus to other countries for a juicy gain. The supply of crude oil to be refined in Cuba was halved in 2016 and so were its exports.

In 2001-2014, the Intergovernmental Commission of the two countries approved 475 Venezuelan investment projects in Cuba worth \$8 billion. An additional \$2.5 billion was allocated by three Venezuelan agencies. Some of these projects were not carried out or stopped after 2014, but Venezuela's foreign direct investment (FDI) has been substantial, especially in the Cienfuegos refinery.

The total value of Cuba-Venezuela's relationship peaked at \$16 billion in 2012 and declined to \$8 billion in 2017; as a percentage of GDP it fell from 22% to 8% (Figure 2).

FIGURE 2. CUBA-VENEZUELA ECONOMIC RELATIONSHIP AS A PERCENTAGE OF CUBA'S GDP, 2007-2017





A fall in Venezuela's regime would lead to \$8 billion losses in total, including \$5.8 billion in exports of professional services and \$1.8 billion in oil supplies. Additional effects would include a deficit in the balance of payments; a halt of disbursements of the restructured debt (already happened); a worsening of defaults to foreign suppliers; a harsh cut in imports, worsening agricultural output and exacerbating current scarcities; long power blackouts affecting the population; interruption of work at factories and transportation problems; two-digit inflation due to a further rise in monetary liquidity; a depreciation in the exchange rate; and a GDP decline in the range of 5% to 7%.

3. The Impact of Trump's Sanctions

The Cuban economy has further suffered due to Trump's sanctions. The application of Title III of the Helms-Burton Act authorizes U.S. citizens to sue in U.S. courts, foreign companies that "traffic" in property confiscated by the Cuban government. The 5,913 certified lawsuits are worth \$8 billion, including accrued interest; another 200,000 uncertified claims are worth billions. The most serious effect of these claims is the disincentive to attract new flows of direct foreign investment (DFI) to the Island, making it impossible to meet the state goal of \$2.5 billion annually.

The number of U.S. tourists shrank 22% in 2019 due to the ban of U.S. cruises, flights to Cuban provinces, trips except for family reunion, and lodging in hotels and restaurants managed by the military. The cost of these sanctions is about \$1.3 billion (to rise in 2020 when Trump's measures are fully applied); private micro-businesses are being damaged already.

Strengthening sanctions on international banks that do business with Cuba have led to fines of around \$12 billion and the closing of multiple bank accounts of Cuban companies, making it even more difficult for the government to conduct transactions with foreign banks and obtain private credit.

The reduction in Venezuelan oil-shipments to Cuba has provoked fuel shortages; a slowdown in the output of some factories, sugar mills, and hotel construction; reduced work-hours in state enterprises, offices, and schools; induced gas station long lines; and cuts in the liquid gas supply to 1.7 million families, but not large power blackouts yet.

The Trump administration imposed a cap of \$4,000 annually per person on remittances in 2019, exempting private micro-entrepreneurs on the Island. The cap, however, is largely irrelevant as most Cuban Americans do not send such a high level of remittances.

Despite the hurtful effects discussed above, the present crisis in Cuba would probably be of a lesser magnitude than that of the 1990s because of diverse current conditions: more diversified trade partners, foreign investment, tourism revenue, foreign remittances and private employment, and lower dependency on imported fuels. Notwithstanding, Trump's sanctions may disrupt all these positive factors. Finally, it is unlikely that either Russia or China will entirely replace Venezuela, although they could help Cuba with trade and economic aid.

Policies For The Future

Cuba can do virtually nothing to change the two external factors causing the crisis; hence it must concentrate on the flawed internal economic model. And yet, Cuban leaders have not elaborated an urgent, innovative, cohesive, and appropriate strategy. In mid-2019 the Cuban legislature approved a long-term plan to 2030 in three stages, without offering details for each; measures were vague and reiterated old unsuccessful policies, emphasizing central planning and state enterprises with scarce mention of the needed acceleration-deepening of the reforms. The Minister of Economics Alejandro Gil identified key sectors to confront the crisis (e.g., tourism, exports of professional services, energy), but acknowledged that exports had not grown enough (they actually declined), foreign investment is low, and energy sources are poorly used. Several Cuban economists have argued that the government strategy is marred by excessive caution, lack of imagination and quickness to confront the challenges, and dearth of discussion on priority reforms, such as private property.

In 2019, President Díaz-Canel promised to replace administrative controls in planning by financial incentives, decentralize and bestow real autonomy to state enterprises, enact an enterprise law to eliminate restrictions to micro-business, decentralize foreign trade, and increase FDI. Half a year later none of these promises has materialized. However, state-employees' wages were increased by 37% in the non-enterprise sector, as well as pensions, actions that most Cuban economists judged would feed inflation; contrary to the decentralization promised, the government put

caps on prices of goods in the private sector. Also, the U.S. dollar was reintroduced to buy certain goods (e.g., domestic appliances, cars) in new state shops, although Minister Gil dismissed a return to full dollarization as in the 1990s. At the start of 2020 a journalist asked Gil about the results of the government's alleged 28 measures to cope with the crisis: he mentioned only three, failed to give concrete data, and conceded: "Unfortunately these measures, some more than others, have been dealt with in a slow fashion... because changing the mentality takes time" (my translations throughout). He admitted delays in payments to foreign suppliers, no advances in foreign investment ("its solution depends on us and has nothing to do with the [U.S.] blockade"), that the goal of replacing imports for tourism with domestic production had not been achieved, and that sales of goods in dollars was limited due to high dependence on their imports (Gil, 2020).



Several well-known Cuban economists have proposed more daring policies that I have fully supported:

- Carry out monetary and exchange-rate unification
- Carry out a comprehensive price reform
- Authorize professionals to work as self-employed and eliminate excessive barriers to the non-state sector
- Replace the list of authorized self-employed activities by a list of banned activities
- End the experimental stage for NASC and approve more of them
- Eliminate the *acopio* system
- Establish wholesale markets (perhaps even managed by foreign enterprises) to supply needed inputs to the non-state sector
- Let foreign companies contract and pay directly to their employees
- Permit foreign investment (including Cubans abroad) in microenterprises and NASC
- Establish banks—including foreign—that provide micro-credit
- Allow the non-state sector to import and export directly
- Eliminate the toughest taxes on micro-businesses
- Impose the levy on profit rather than on gross revenue and permit the full deduction of expenses
- Authorize an independent association of micro-entrepreneurs with power to negotiate conditions with the government and get involved in pertinent legislation; and
- Create a channel to denounce corrupt state officials that collect bribes from non-state workers (Díaz, 2020).

I have submitted that if Cuba were to follow, with the needed adjustments, the successful Sino-Vietnamese model, especially in agriculture (allowing all farmers to plant what they want and sell all their crops to whoever they please at prices set by supply and demand), the Island would be self-sufficient in food in six or seven years and survive the current crisis. Also required would be a faster expansion of the private sector and transforming the central plan into a guide for development. Díaz-Canel (2020) recently rejected this idea: “Concerning the proposals of Cuban economists of analyzing the Chinese and Vietnamese economic models, adapting them to Cuba, we have studied such experiences, but none of these countries has been submitted to an embargo for six decades [Vietnam was, although for less time]... some of those economists only think about the private sector whereas the government’s premise is that the principal economic actor is the state sector with the private sector playing a complementary role.”

With such *continuismo*, the crisis will not abate.

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