A LOOK AT THE REFORMS

- THE ECONOMIC REFORM IN CUBA: STUCK IN THE MIDDLE

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1. Stuck in the middle

a series of reforms and stabilisation measures of varying nature and scope have been implemented in the Cuban economy over the past decade. Many were obligatory responses to accumulated macroeconomic imbalances, but other reforms sought to lay the foundations for more vigorous and sustained future growth. For the time being, any achievements of this process appear insufficient and remarkably fragile.

In the last two decades may *reforms* have been implemented. More precisely, progress has been made on consolidating a private sector (the self-employed and microenterprises) that is tremendously dynamic and creative, albeit confined to certain minor services and circumscribed by highly restrictive regulations[1]; efforts have been made to increase the flexibility of central planning tools and to improve macroeconomic management; the financial system and the role of the central bank have been redesigned in a very idiosyncratic institutional context; a major obstacle to the country's access to international financing has been removed through the intelligent negotiation of its external debt with the Paris Club; and, finally, the regulations on agriculture and foreign direct investment have also been reformed, although in both cases significant restrictions remain. All these (partial) achievements should be recognised. But the truth is that the economy has failed either to launch a process of sustainable productive transformation, or to achieve a growth rate that may be considered acceptable.[2]

Proof of the unsatisfactory results of this process is that long-diagnosed problems with the Cuban economy persist, among which the decapitalisation of the economy is one of the most important. Midway through the past decade, the endowment of physical capital measured in dollars was 37% lower than in 1989 (Vidal, 2017) – consistent with remarkably low rates of saving and investment (between 10% and 15% of GDP). These low rates reflect the limited expectations of profitability in a regulatory framework that is both restrictive and insecure for investors, whether domestic or foreign. The context of low investment seriously undermines the capacity to undertake the productive change the Cuban

1. On the restrictions the private sector faces, see Mesa-Lago (2016), Díaz and Barreiro (2019) and Ritter and Henken (2015).
2. The economic reforms are evaluated in Alonso and Vidal (2013), as well as in *Miradas sobre la Economía Cubana*, produced by the Centro de Estudios de la Economía Cubana over a number of years.

economy needs, in order to increase the level of productive diversification and bring greater economic dynamism and competitive strength. One example is the inability to diversify the export supply, which has been seriously damaged in some fields by weakened competitiveness and the geopolitical changes in the country's surroundings. US sanctions – tightened by the Trump administration – have made it all the more difficult for the foreign sector to act as a lever for mobilising economic change.

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The root of the Cuban economy's unsatisfactory functioning is the distorting persistence of monetary duality, which gives rise to multiple divided markets, hampers the competitive potential of domestic products and leads capacity to be diverted towards low-productivity activities. This is not the only area that requires urgent reform: this chapter covers the labour market and recruitment by national and international employers, better regulation of foreign investment to provide autonomy and security to investors, or the creation of wholesale markets to supply the private sector, among the pending reforms.

Finally, these long-term problems are added to other more recent ones that also affect the sustainability of the growth path. Increased inequality is one trend prompting concern as it tarnishes one of the Cuban regime's distinguishing features. The ageing population is also worrying. This demographic change is becoming consolidated and has highly diverse effects (not just economic) on the configuration of savings, the rigidity of public spending and the lack of dynamism in the Cuban economy.

The achievements in terms of stabilisation are equally ambiguous. In the first term of Raúl Castro's presidency (2008–2013), the financial crisis was overcome, inflation was kept under control and public accounts were strictly monitored in an attempt to arrest the drift towards a worsening state deficit. However, in the second period of the presidency (2013–2018) it became clear that the Cuban economy remained highly vulnerable to external shocks, particularly given the increasingly adverse international context. Lower international raw materials prices and the Venezuelan crisis have heaped pressure on Cuban external accounts over the past five years. More recently, these pressures have been added to by the impact of US sanctions on tourism and on the financial risk of the Cuban market. What is more, the economy's very configuration causes imbalances to worsen as growth rates slow, due to the central role the state plays in regulating the economic cycle, in debt management and in supporting family incomes. As a result, imbalances repeatedly emerge and the remedies employed become increasingly costly because of their recessionary effect, as a major part of the adjustment affects import capacity.

In fact, evidence from this last period suggests that the strategy adopted has created an underlying contradiction between the two purposes of the government's action: reform on the one hand and macroeconomic stabilisation on the other. Because they are gradual and partial, the reforms are unable to unleash the intended process of productive change and economic dynamism. This forces the state – in an adverse international context – to maintain a palliative policy that aims to protect revenues and contain prices (particularly the exchange rate). But in a context of a severe constraint of public resources, economic recessions drive to exacerbate the macroeconomic and financial imbalances. Correcting these imbalances requires public spending to be contained and import capacity to be restricted, eliminating the limited possibilities of sustaining a continued economic growth rate.

Accounting for differences, this contradiction is present in all structural adjustment operations. Macroeconomic adjustment is expected to have some recessionary effects, but they are also expected to be short-term. It is hoped that, if well targeted, economic reforms will lay the foundations for healthier and more dynamic growth of the economy, producing an impact that ends up prevailing in the medium term. Cuba is a peculiar case because the reforms are not having this dynamic effect (or if they are the impact is very slight). Largely this is because the reforms are partial and fragmentary. The absence of a comprehensive approach prevent that certain measures deploy their effects because of the absence of other complementary reforms that would be equally required.

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As a result, the Cuban economy appears trapped in a vicious circle. Recurrent imbalances oblige stabilisation measures to be imposed that inevitably damage the prospects of reform and economic growth. In turn, the partial nature of the reforms means they are unable to trigger the expected dynamism, which means palliative public action is required, creating new imbalances. The sequencing and partial nature of the measures adopted has left the Cuban economy in an undesirable situation in which past logic has been cast aside but no new economic rationale has been allowed to succeed. Cuba has for years appeared to be in no man's land, stuck in the middle of a process of change.

Overcoming these problems requires the Cuban economy to break out of the vicious circle in which it has been locked in recent years. A first condition for this is to design and implement a comprehensive programme of reforms in which the externalities of the measures to be adopted are weighed and the process is endowed with the ambition and coherence it has thus far lacked. This means accepting major institutional and regulatory changes in key areas, such as the exchange rate regime, factor markets (capital and labour) and economic regulation and allocation systems. Undertaking these reforms will temporarily have a potentially negative effect on the population's living conditions and on the government's scope for action. That is why it is important that the design and implementation of this plan is accompanied by broad social support and guaranteed access for the country to international financing in conditions and quantities that allow it to properly manage the transition.

The Cuban economy's high-quality human capital, relative health and safety advantages, experienced public bureaucracy, prosperous diaspora and location in a region of high tourist demand are all positive factors that can contribute to make a comprehensive process of adjustment and reforms successful, even if the US government's economic and financial sanctions are maintained. But this process of changes require both political will and far-reaching vision.

This chapter intends to provide some interpretations and evidence to help support the arguments made in the introduction. It is clear that Cuba has moved from a long first stage in which the reforms were understood as a necessary but reversible evil (1990–2008) to one in which the reforms are seen as desirable. But the process, until now, has lacked an integrated conception and a cumulative and dynamic sequence of change. It is important that this stage is concluded and that the reform is contemplated with the appropriate ambition for a simultaneous and comprehensive plan of action.

2. The difficulties of institutional change

All economic reform processes involve forcing through institutional change – modifying the framework of incentives in which economic actors operate. Understanding the difficulties of institutional change can help us interpret the resistance to economic reform in Cuba.[3]

In principle, the vision of institutional change seems in each case to be conditioned by the conception of the institutions. When identified with rules imposed exogenously on individuals, institutional change is taken to be a centralised process carried out by those with the capacity to define the rules (authorities, government, parliament). In such cases, the institutional change is deliberate and is normally accompanied by a struggle between the interest groups impacted by the reform (Ostrom, 2005).

This vision provides an accurate account of how legislative processes occur in a democratic society. But while potentially useful for explaining certain processes of institutional reform, this conception struggles to convincingly account for how informal institutions evolve and why, in some cases, formal institutions fail to effectively shape social action or to provide the results expected of them (Kingston and Caballero, 2009).

Other approaches insist that institutions should be conceived of as self-sustained equilibria in social interaction. In this case, institutional change is principally an evolving, decentralised process. When actors observe that the results of an institutional arrangement are not as expected, they modify their expectations and alter their behaviour. As the dissonance continues to grow, actors cease to behave in accordance with the established rules, which weakens their enforceability and effectiveness. In such cases, the opportunity opens up for endogenous institutional change (Greif, 2006).

An eclectic approach might accept that institutional change can be enacted in various ways that are not necessarily incompatible. While some changes may be produced by the explicit definition of new rules via a political process of negotiation and struggle between the interests at stake within society, in other cases institutional modifications will result from decentralised processes that are open to innovation and only partly intentional. Neither process of change requires it to be guaranteed that the capacity exists to define optimal institutions.

Whatever conception one adopts, it must be recognised that institutional change is a complex task, fraught with uncertainty and only partly controlled by the social agents that promote it. In order to clarify this, the distinction between informal and formal institution can be useful.

3. A canonical definition would understand "institutions" to be the rules of the game in a society or, more formally, the restrictions produced by human beings that shape social interactions (North, 1991: 97).

Informal institutions lay on unwritten social norms or conventions rooted in the consciences of individuals, in their values and in their culture. They explain human behaviour by reference to deep and not always conscious factors. Because of their nature, these types of institutions tend to change slowly and gradually, responding to mutations in their environment or in the consciousnesses of individuals that take shape over time. Informal institutions are likely to change in a decentralised and somewhat blind process that may be slow to spread from the groups that initially promote it to the social group. This makes it difficult to foster and even more difficult to control.

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By contrast, formal institutions define explicit rules and establish clear sanctions for non-compliance. Their design is more deliberate (e.g. a law) and is subject to a more transparent process of definition and public scrutiny. They are therefore easier to deliberately change. Even so, the difficulties involved in this task are numerous. Among them we would like to highlight the following four:

- First, even when there is clear awareness of institutional failure, the alternative institutional arrangement that would provide a solution may be less obvious.
- Second, even if the alternative is clear, in order to motivate any institutional change, the inertia (resistance to change) in existing institutions must be overcome. This inertia is the product of highly diverse factors related to the interdependencies between institutions (to change one, associated others must also be changed), the network of explicit and implicit social commitments on which their operation rests, and the objectification of values, expectations and beliefs the institution promotes in the social fabric.
- Third, all institutional change involves altering pre-existing patterns of distribution, not only in the economic sphere, but also in terms of voice and power in society. For change to occur it is therefore necessary to overcome the resistance of those who feel potentially harmed (even in relative terms) by this process.
- Finally, a well-designed institutional alternative and overcoming the resistance put up by inertia and the action of sectors that oppose the change are not sufficient: it is also necessary to invest in disseminating the norm so that actors understand it and internalise it in their behaviour.

These factors explain the difficulties with institutional change. They also help understand why the costs of creating a new institution are higher than of preserving the immobile behaviour of existing ones, even when these are deficient. The conditions for change are created only when the advantages of the new (or the shortcomings of the old) are very marked.

Given the powerful inertia that characterises existing institutions, analysts have tended to conceive of institutional change as a sporadic process in which long periods of stability coexist with episodes of abrupt change. Overcoming this inertia is easier when society enters the episodes of social disruption or essential periods of change known as "critical junctures" (Capoccia and Kelemen, 2007; Acemoglu and Robinson, 2012). When major events disrupt a country's economic or political equilibrium, society is more likely to be willing to question its prior expectations and beliefs, facilitating the search for and acceptance of new institutional arrangements.

Without detracting from these processes, it must be recognised that much institutional change does not fit the model of abrupt transformations concentrated in critical moments. Rather, change occurs through a (sometimes prolonged) sequence of gradual modifications. Mahoney and Thelen (2010) believe this process of change occurs fundamentally in three ways:[4] i) *layering,* where new laws are introduced to reinterpret or condition existing ones; ii) *drift*, where laws are reinterpreted due to changes in the context; and iii) *conversion*, when the definition of existing laws is changed due to a strategic rearrangement of the rules.

Levitsky and Murillo (2014) offer a third option for institutional change, based on the study of a large number of Latin American countries. The authors cite cases in which institutions are built on fragile foundations and lack the necessary rooting in society due to high levels of social fragmentation and political instability. In such cases, institutions may undergo changes that are intense (as opposed to gradual) and continuous (rather than one-off), giving the institutional framework particular volatility: Levitsky and Murillo (ibid.) call this "serial replacement". The consequence is that the institutions have a low degree of predictability and capacity to modulate people's behaviour.

Finally, Alonso (2020) presents a fourth case, the inverse situation, in which particular institutional inertia means societies are unable to keep up with social change by modifying their institutional structure. This usually occurs in countries with rigid, authoritarian political structures, low levels of recognition of political and civil rights, and where traditional values have particular importance. Dissonance tends to grow progressively between a society that evolves (albeit slowly) and institutional structures that are reluctant to change, and to which only minor adjustments are made at critical moments. In these cases, a gap widens between society (its interests and expectations) and the existing formal institutions, which lose legitimacy as they appear increasingly maladapted to the needs of the moment. Arab countries provide good examples of this type of situation, as the "Arab Spring" revealed.

3. Institutional reform in Cuba

The previous section presented some examples that help understand the reform process in Cuba. With all its peculiarities, Cuba seems to be close to the last of the models discussed: institutional inertia is imposed on a society that has nevertheless undergone a notable change in its values, patterns of behaviour and expectations.

In the economic sphere, disparity appears to be growing between the formal institutional framework, where the changes have been incremental, and the growing demands (and expectations) for change in society itself. The most decisive factors behind the institutional inertia relate to the rigidity of the political structures and society's limited capacity to autonomously transfer this demand for change to the institutional framework. Hierarchical bureaucratic decision-making processes prevail over more spontaneous, decentralised expressions of social demands and expectations. Often, the informal bottom-up dynamics that promote changes in behaviours and values end up colliding with top-down formal decision-making structures seeking to reproduce themselves. This does

4. The authors also consider a fourth type, displacement, in which existing rules are replaced by new ones. But this process is not necessarily "gradual".

not mean institutional change is non-existent, but that it is conditioned by the requirements of the rigid political structures in which these changes are determined. Neither does it necessarily mean that public opinion is disregarded. But the degrees of autonomy with which it expresses itself are notably limited, as the issuing of opinion itself is centrally organised (as the referendum about the new Constitution, in 2019, shew).

The circumstances described have two important consequences that condition the effectiveness of the economic reform process: the absence of a recognisable goal and an its incremental, fragmented nature.

3.1. Absence of goals

The economic reform process proposed in Cuba lacks a defined destination scenario towards which efforts are guided. Acceptance exists that successive institutional changes are necessary, but a precise (and intellectually consistent) definition of the final goal of this reform process is omitted. Documents presented as strategies (*Los lineamientos de política económica y social del partido y la revolución para el período 2016-2021* and the *Plan nacional de desarrollo económico y social 2030 de Cuba*) are in fact political texts written in a declarative tone that are of little use for defining a recognisable economic model. Not even the *Conceptualización del modelo económico y social cubano de desarrollo socialista* fulfils that purpose, being a somewhat desiderative text that lacks precision in terms of strategies and defining the future economic framework.

The lack of definition of an arriving scenario drives to contradictory approaches. For example, official documents insist on preserving the socialist nature of the economic model in Cuba, but the reality shows that 30% of employment is already associated with private activities and that the door has been opened to investments with 100% foreign capital. In the official media, praise for the Chinese and Vietnamese models is mixed with criticism of the activities of the private sector. The international context, dominated by the crisis in Venezuela and the reaction of the Trump administration, does not help openly reformist attitudes to prosper within the government. And, finally, the sequencing of the decisions sows doubts about the objectives of the reforms. This is the case, for example, with some measures on the current president's economic agenda that resurrect transformations from the 1990s that appeared to have been consigned to the past, such as the partial re-dollarisation of certain markets and industries, in apparent contradiction with the long-proposed monetary unification.

The reform path therefore has a clear starting point (a past whose achievements are recognised, but to which return is not wanted) and some recognisable milestones, but lacks precise goals and timelines, which would impose discipline on public decisions and allow actors to adapt their behaviour and expectations to these reforms. The result is that in the absence of commitments on the pace of reforms, the authorities possess a high degree of discretion when it comes to decision-making. That discretion gives extra leeway to sectors that are resistant to change, enabling them to organise and attempt to delay or deprioritise the reforms they consider most damaging to their interests.

What is more, in this uncertain environment, social actors are unable to anticipate changes: their attitude is one of permanent expectation, waiting for the confirmation of a new reform. Their uncertainty (which extends to international companies operating in Cuba) not only limits their effective involvement in supporting the reforms, but also damages their willingness to invest, given the absence of credible medium-term scenarios. No surprise then that levels of savings and investment on the island are low.

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3.2. Partial reforms

The absence of a precise goal explains the lack of a systematic and comprehensive reform plan. Any overall logic is lost to stop-gap solutions: concatenated partial decisions taken when problems are detected, according to the political margins available for solving them. In some cases, decisions seek to advance previously postponed reforms (e.g. financial reform);[5] in others, they look to correct inadvertent consequences or gaps left by previous interventions (for example, the agricultural sector's commercialisation system). At any rate, the process is governed more by piecing together partial actions than by the rationale of a comprehensive plan.

Seen as a whole, then, the problem is not that there are no reforms. Indeed, various – some far-reaching – have been adopted in recent years: among others, the authorisation to possess mobile phones (2008); the opening up of the real estate market (2008); the regulation of internet access (2009); the liberalisation of access to construction materials (2011); the liberalisation of international travel (2013); the various changes in the regulation of self-employment; the extension of the period of usufruct of state land; and the new regulation on the central bank and the financial system (2018). The problem is that many of these changes fail to achieve the intended effect because they are not accompanied by reforms in other complementary areas.

In this regard, it should be remembered that the institutional framework, far from being an aggregate of juxtaposed institutional arrangements, is formed of an articulated and hierarchical fabric of institutions. Within that fabric institutional aggregates exist – groups of intimately connected institutions, each of whose operational logics is highly dependent on those of the others. This reality conspires against the partial, fragmentary approach taken to the reforms in Cuba, because the impact of measures applied in one area is reduced by the absence of complementary reforms in others. Nevertheless, achieving partial successes is crucial, especially if a gradual, long-term path of reform is adopted. It allows the sequential broadening of social support for the process (reducing the space for sectors that are resistant to change) and extends the viability of the subsequent reforms. In the case of Cuba, the partial nature of the reforms means both objectives are achieved in a very limited way.

Three examples illustrate the argument. The first relates to *foreign investment*, the great hope of many Cuban political leaders, who believe that attracting investment is the main factor behind motivating productive change, improving the economy's productivity and competitiveness and encouraging growth. Over time, regulatory changes have sought

5. For a recent analysis of the financial system and its relationship with the private sector see Vidal and Viswanath (2019) and Pons (2016).

a degree of liberalisation in this area. In 2018, for example, the Cuban government modified Law 118 on Foreign Investment, supposedly with a view to accelerating the arrival of foreign capital. When making investment proposals, investors were no longer required to submit two documents to the Ministry of Foreign Trade and Foreign Investment, and the submission of a full feasibility study was dropped in favour of a simpler pre-feasibility study.

Nevertheless, the results of this liberalisation process are far from the expected and, on occasions, announced. At the root of this discrepancy are two factors that have yet to be subject to reform. The first relates to the previous point: foreign investors suffer from the uncertainty resulting from the absence of a credible reform plan that identifies the desired end scenario (economic model). These factors of uncertainty are overcome only in activities in which the location advantages are high (as with tourism) or where extraordinary revenues are on offer thanks to the absence of competition. The second factor relates to the limitation the Cuban authorities imposed on the free recruitment of labour on the island. State employment agencies constitute a restriction that affects not only the selection of personnel, but also their compensation and incentives. As long as factors such as these go unaltered, foreign investment is unlikely to arrive at the desired rates, even if other aspects of the regulations are made more flexible.

The second example is *agriculture reforms* . Once again this is a sector the authorities consider strategic, not only as a source of productive jobs (in an environment of increasing underemployment and informality), but also as a way to improve the levels of self-sufficiency and to reduce the high dependence on food imports. One of the star measures in this process is the regulation of access to the usufruct of land for the promotion of agricultural operations. Again, faced with limited results, the authorities had to amend the rule and lengthen the period of usufruct to give the investor greater security. However, as these updates did not bring about the dismantling of the centralised system of purchasing and allocating materials, the results continue to be disappointing. The usufruct time limit is undoubtedly a factor of uncertainty, especially in an area in which investments for productive improvement require long periods to fully mature. But, beyond this, low yields are influenced by the farmer's inability to control the productive cycle.[6] Once again, we find measures that do not bear fruit due to the absence of complementary reforms.

The last example is the *policy to promote the competitiveness* of Cuban companies. The reform insists on the pre-eminence of state ownership and monopoly in most industries and – a little extra flexibility aside – retains the logic of resource allocation by a central plan. Once again, this is an area in which highly diverse formulas have been explored at different stages, for the most part experimentally, adjusting the degree of responsibility transferred to the employer in decision-making and the formulas for improving access to finance in foreign currency. The Raúl Castro government's commitment to restructuring the state business apparatus rested fundamentally on the creation of the Superior Organizations of Business Management (OSDEs), which failed to improve efficiency, make productive processes more flexible, or enhance the use of scientific potential, as the government had aimed.[7]

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6. Nova (2013) contains a full analysis of the Cuban agricultural sector.
7. See Decree 335 in the *Gaceta Oficial Extraordinaria* No. 58 of December 13th 2017. De Miranda and Pérez (2012) assess the challenges the economy faced in the first years of the Raúl Castro presidency; Triana (2016) characterises some of the distinguishing features of its reforms.

As yet, the process has failed to translate into an effective pathway of competitive improvement for the Cuban state company. The absence of reforms in two key fields lies behind these limited achievements: the possibility of employers optimising costs through free access to the input and factor markets; and the unification of the exchange rate and its external convertibility, establishing currency parity to make it possible to regain competitiveness and manage international operations. Under these conditions, trying to improve competitiveness by transferring decision-making responsibility to the employer is pie in the sky. Most of the state industries survive by paying very low wages and receiving subsidies – either explicitly from the budget, or implicitly from the overvalued official exchange rate. Keeping such state companies afloat reduces the average productivity of the state business sector, which conditions its low wages and leads to an inefficient allocation of the workforce – inexcusable given that Cuban demographics are characterised by emigration and an ageing population.

To sum up, the lack of a comprehensive reform plan and the fragmented, partial nature of the reforms mean that any changes produced have much less impact than expected. The consequences of the internal changes have failed either to reach the majority of the population that depends on state employment or is retired, or to improve the levels of competitiveness and growth of the economy on an aggregate scale.

4. Vulnerable international insertion

Since 2015, Cuba has been trying to assimilate the impact of the fall in trade with Venezuela (see Figure 1). Goods imports from Venezuela (including oil) have fallen by around $4.5 billion. At the same time, Cuban exports of goods to Venezuela (including medicines and refined oil) decreased by around $2 billion, while exports of professional services (including medical services) fell by another $1.5 billion. These trends are fuelled by the progressive deterioration of the economic and political situation in Venezuela, with the country's GDP plummeting by about 60% between 2014 and 2019.

If there is regime change in Venezuela, trade agreements with the country are at risk of collapse. It is not possible at this stage to know exactly what will happen in Venezuela, but in all of the plausible scenarios, the Cuban economy will emerge further weakened. While Maduro remains in power, he will struggle to reverse the deterioration of the Venezuelan economy in the medium term. But the fall of the Maduro regime would have highly damaging consequences for incomes, family consumption and monetary and financial stability in the Cuban economy, even if the decline is less severe than that experienced in the Special Period in the 1990s (Mesa-Lago and Vidal, 2019).

Figure 1 shows the changes in Cuba's dependence on an "allied country" as a percentage of Cuba's GDP, taken at constant prices. For 1980–1993 this percentage is calculated for the trade with the former USSR and for 2001–2017 that with Venezuela is given. These periods correspond to the years in which special agreements existed between these nations and Cuba. For 1994–2000, the historical series is given zero value, as Cuba had no economic relations of the same nature with any country.

It can be seen that before the Special Period, trade relations with the USSR represented 28.2% of GDP, while they currently represent 12.4% with Venezuela, around 16 percentage points less. This single indicator suggests that while in principle severing ties with Venezuela should have a significant negative impact on the Cuban economy, it will be less than that experienced in the 1990s after the collapse of the USSR.

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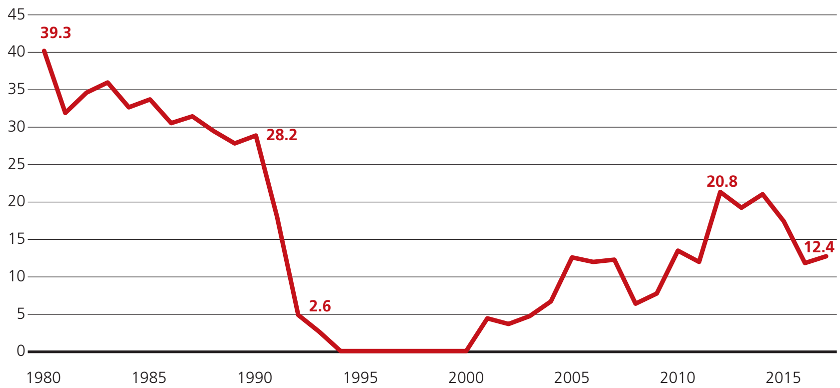
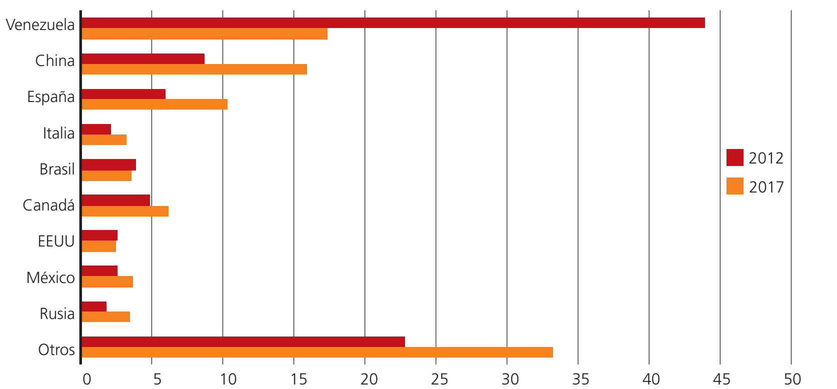
Figure 1. Cuba: Changing dependence on an "allied country" (Trade with the country/Cuban GDP, at constant prices: with the USSR [1980–1993] and with Venezuela [2001–2017])



Source: Cuba Standard (2019).

Figure 2. Cuba: Trade in goods by country (% of total)



Source: Cuba Standard (2019)

Analysing the exchange of Cuban goods (exports plus imports) with its main trading partners shows that as trade with Venezuela fell, exchanges were increasing with China and Spain. China's share of total trade has almost doubled, rising from 8.8% to 16%, while that with Spain rose from 6% to 10.4% in the 2012–2017 period. Another country to increase its absolute and relative participation in Cuban trade was Russia, which grew from 1.8% to 3.4% in the period under consideration (Figure 2). However, these rises are not enough to compensate for the lost trade with Venezuela. Other markets (such as Italy, Canada and Mexico) increased their relative trade with Cuba, although this did not translate into an increase in trade values in absolute terms.

In this context, the complex situation in Venezuela and the new actions taken by the Trump administration raise concerns about how new crises will be handled and the possible implications for the reform dynamics. That the starting point is more favourable than in the 1990s is acknowledged, but the economy is a long way from healthy. Otherwise, over these years Cuban society has been left exhausted by frustrated expectations of economic change and uncompensated social deficits that would make bearing a new period of severe crisis extremely difficult. Concern rise about the social and political impacts, as some families that depend on depressed state pensions and real state wages will struggle to survive a new adjustment. To summarise, even if the impact is less than in the Special Period, for families without access to remittances who are not connected to the private sector or to tourism, the social cost of inflation and product shortages in rationed markets could be extremely high, generating significant challenges in terms of social policy, as well as for the political management of the crisis.

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5. The re-emergence of macroeconomic imbalances

In macroeconomic terms, three factors have partially offset the lost exports and imports with Venezuela: tourism, the private sector and remittances, and fiscal policy. But their sustainability is at risk. In 2018 and 2019, tourist arrivals and export earnings clearly slowed. Rates of growth in the private sector and inflows of remittances also fell. There is no certainty (at least in the short term) that either of these two factors can regain their previous rates of expansion. Finally, the tone of the previous fiscal policy is not sustainable either, considering the dimensions to which the fiscal deficit and public bonds accumulated by state banks have grown. The Cuban government therefore needs to find new buffers to face this potential crisis.

In this new scenario, the vicious circle in which the Cuban economy finds itself is exacerbated. The incomplete reforms and resulting low GDP growth combine with the effect of new external shocks, producing a new outbreak of macroeconomic and financial imbalances. The responses to these imbalances have clearly recessionary effects, as they worsen macroeconomic balances, increase indebtedness, reduce import capacity and multiply non-payments to international suppliers, which combine to undermine the potential for long-term economic growth. At the end of 2019, worrying signs were also appearing in the banking sector, which showed itself unable to meet the liquidity demands of certain savers. The operational capacity of Cuban banks suffers from the lack of convertibility of the Cuban convertible peso (CUC) and the financing of government budget deficits. Further bank instability would have fatal consequences for the Cuban economy's capacity to reorganise and recover.

There is no consumer price index (CPI) data for 2019, but informal information cites significant price increases in the markets for various products, including eggs, milk, meat and building materials, among others. In 2018, the official CPI figure in Cuban pesos (CUP) was just 2.4%. However, this CPI suffers from various calculation issues and leaves out the prices in CUC. Given the product shortages experienced since 2019, inflation could further accelerate in the immediate future.

In the past, the inflationary process was basically fuelled by supply factors (restrictions on the availability of goods), while an attempt was made to maintain a fiscal policy aimed at avoiding additional inflationary pressures. This was one of the flagship economic policies of the first years of Raúl Castro's presidency: in fact, to overcome the 2008–2009 financial crisis, a significant adjustment was applied to imports and the fiscal deficit was reduced from 6.7% in 2008 to 1.3% in 2013. These results, allied to a more even balance of payments and the renegotiation of the external debt (including with the Paris Club), seemed to denote healthy macroeconomic management that could contribute to creating a favourable climate for developing investment and trade projects with the island. However, the new external shocks led fiscal policy to undergo a change of tone, becoming increasingly expansionary after 2015. Fiscal expenditure rose to 66% of GDP and the fiscal deficit reached new highs: in fact, as a proportion of GDP, the 2018 fiscal deficit was the highest since 1993.

In the past, the preferred way of financing the public deficit has been the issuance of public bonds, which are purchased by state commercial banks. However, this mechanism is also beginning to show signs of saturation, reaching levels that may prompt concerns about their effects on financial and banking stability.

Against all predictions, as of August 2019 the Cuban government decreed a 68% increase in the average nominal salary for half of the employees in the state sector. As these salaries depend on the budgets, the decision implies an equivalent of 12% of total public spending, exceeding the size of the predicted deficit. The price effects seem inevitable: higher incomes will increase demand in a context of scarcity in consumer markets. To contain inflation, the Ministry of Finance and Prices issued a price cap on a wide range of goods in the state, private and cooperative business sectors. Salary increases without productive support and administrative price controls are not the measures needed to tackle economic stagnation and provide another example of the vicious circle to which we have referred throughout these pages.

In monetary terms, a new course has been embarked upon that seems to contradict the anticipated monetary unification. Since November 2019, some consumer markets have been organised to work in dollars that will be better supplied than the current CUC markets. State-owned companies that sell in these markets will be able to use the currencies to directly import their inputs without needing the approval of the central plan and without having to deal with the lack of convertibility of local currencies. Far from shifting the system towards monetary unification, this partial re-dollarisation of the markets is a response to the need for quick relief from the growing financial imbalances. It is, in short, another partial, fragmented transformation that is inconsistent with what should be the final objectives of the economic reform.

6. The immediate future

Despite the reforms undertaken in recent years, it must be recognised that the economic challenges faced by President Díaz-Canel, far from easing, have actually become more complex. In the coming economic juncture, the Cuban government will continue to struggle with GDP stagnation/recession, the crisis of non-payment of external creditors and the continual shortage of basic products for families. The government will have to decide the speed and depth with which it continues the reforms begun by Raúl Castro, within the margins granted by the new constitution approved in February 2019. Added to this, in the international arena, tighter sanctions imposed by the United States government will have to be faced, along with the crisis in Venezuela, which puts the economy's capacity to attract capital and sustain its foreign income at serious risk.[8]

In everyday life, citizens face shortages of food products that form part of the usual Cuban diet, such as chicken and oil, as well as basic hygiene products, among others. Not only are food imports falling, the constraints also affect fuel and other inputs and productive equipment, which is having an effect on the normal functioning of domestic production.

Faced with this adverse international environment, the Cuban economy needs to find new buffers to withstand the Venezuelan shock. Many have begun to look abroad again, seeking the redemptive partner to fill the space left first by the USSR and later Venezuela.

Faced with this adverse international environment, the Cuban economy needs to find new buffers to withstand the Venezuelan shock. Many have begun to look abroad again, seeking the redemptive partner to fill the space left first by the USSR and later Venezuela. This is a chimera: no country is currently in a position to offer such favourable and concessional relations as those Cuba received from its previous strategic allies. As examined in Figure 2, increased trade with other trading partners has not yet been enough to offset the lost trade with Venezuela. Otherwise, experience shows that mitigating external risks depends less on the identification of a hegemonic and reliable preferential partner (whoever that may be) than on having a wide and diversified portfolio of relationships that can be shuffled in unforeseen circumstances.

It should also be emphasised that solving the problems of the Cuban economy seems to lie less in identifying the support that may be raised from abroad (important as that may be), than in the ability to implement a coherent and predictable process of productive and institutional transformations on the island that attract investment and boost the country's productivity. That aim forces the gaze to turn inwards rather than outward, to identify internal capacities rather than external concessions. The goal should not be to change as little as possible in order to preserve the inherited institutional framework, but to move consciously towards a new economic logic that allows the economy to escape the vicious circle in which it now finds itself, promoting a new institutional framework adapted to that purpose.

The country's leaders have yet to demonstrate such determination. The installation of a new head of state has led to new procedures and new – more transparent and collegiate – styles of government, but there has been no turnaround in the trend of incremental, fragmented reforms inherited from the Raúl Castro period. This fits the expectations of a president who reached power not by presenting his own agenda, but by being selected by the "historical" generation to give continuity to the programme defined by his predecessor in office.

The Cuban government continues to bank on attracting foreign investment. The problem is that foreign capital is not arriving in the required magnitude and speed; exports of goods and services are not growing,

8. See Pérez (2018) and Bye (2019) for an examination of the economic and political challenges of the Díaz-Canel presidency.

a trend that also affects tourism; and the most recent decisions on fiscal and monetary issues herald a re-emergence of fiscal imbalances and inflation. To all this must be added the new risks associated with financial and banking stability. The Minister of Economy and the official media appeal to the "reserves of efficiency" in the state sector, trusting that the therapeutic effect of a minor adjustment will not affect the receipt of external income. It does not look particularly promising, but we will have to wait to see whether, given the foreseeable worsening of the situation, the Cuban government decides to deepen the structural changes or maintain its policy of stop-gap solutions.

Finally, economic reform will not occur without concurrent change in the institutional frameworks that govern the economy and the collective decision-making processes in Cuba.

8. Final considerations

An attempt has been made over the previous pages to make three complementary cases. First, it has been pointed out that the Cuban economy has for years been trapped in a vicious circle from which it has been unable to emerge. The consequence of this process is a mediocre growth rate, with low productivity growth and a recurring trend towards macroeconomic imbalances. As a result of the reform process, most of the population has failed to see substantive and sustained improvements in its living conditions.

Second, the trap in which the Cuban economy finds itself has its roots in the partial and unsystematic nature of the reforms adopted. Being fragmented and partial the potential of these reforms cannot be unleashed without the complementary effects of other reforms that have not been carried out. Escaping this vicious circle means adopting an ambitious and comprehensive reform policy, which defines a precise destination timetable and scenario. Access to international financing to facilitate transit should be a central part of that process.

Finally, economic reform will not occur without concurrent change in the institutional frameworks that govern the economy and the collective decision-making processes in Cuba. The reluctance to adopt a more comprehensive reform plan can only be explained by the rigidity of the country's collective decision-making and government structures. They are insensitive to the need to give actors more space for autonomous decision-making. A more flexible and creative economy requires such spaces to be extended. Autonomous decision-making that responds to appropriately designed incentives must be favoured over hierarchical and administrative decision-making. This should be the goal.

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