

CUBA'S STILL MURKY ECONOMIC FUTURE

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Abstract

Cuba today is on the verge of several dramatic changes. In the next few years, the two forces that have shaped Cuban politics and society over the past half-century—the leadership of Fidel and Raul Castro and the bitter hostility of the United States toward the island will have passed into history. And there is another disruptive element approaching—the impending collapse of the Venezuelan economy, which has been a vital source of revenue for Cuba since Chavez first took power in 1998. Indeed, while the opening with the US now holds out the promise for significant economic progress in Cuba, Venezuela's downturn could provoke a humanitarian crisis in the short run. This is now a moment of great uncertainty for Cuba. It is not surprising that Cubans are apprehensive about what comes next, even those that are optimistic about the future and expect the country's prospects to improve.

Cuba's Economic Challenges

According to government statistics, the Cuba economy has been a steady performer in the last several years. It grew by four percent in 2015, well above the Latin America average of less than one percent. Indeed, its growth was the fourth most rapid in the region. But the numbers, even if they are accurate, are deceptive. Poorly served by their country's economy, most Cubans appear to be living in or near poverty and struggling to survive on a daily basis. The economy of Cuba remains one of the region's most vulnerable and least productive.

The hard fact is that Cuba does not produce very much of anything. For some time now, the island has had to import a sizable share of what it consumes, and its export earnings are sufficient to pay only a fraction of its import bill. Year after year, the country spends about twice as much for purchases abroad, and sometimes more, as it brings in from merchandise exports.

For the past 15 years, Venezuela has covered most of the shortfall. It has been the source of more than one third of Cuba's foreign exchange, ostensibly in payment for the services of thousands of Cuban doctors, nurses, and other professionals sent to work in the Bolivarian Republic. Moreover, Venezuela has been supplying Cuba with additional support through subsidized oil shipments, much of which is sold on the international market. Two other major sources of hard currency are tourism and remittances, mainly from Cubans living in the US.

With its mounting economic and political problems, Venezuela has been reducing its support, which may soon evaporate completely. While hardly guaranteed, many Cubans expect that the normalization of US-Cuban ties will lead to substantially expanded trade and tourism flows and generate increased foreign investment, primarily from the US itself, but potentially from many other countries and international institutions as well. But it is unlikely this will happen very quickly—and, as discussed below, will depend on, first, whether and when the US

finally decides to lift its trade embargo and other restrictions on its bilateral relations with Cuba and, even more importantly, on the pace, coherence, and depth of economic reform in Cuba.

Cuba's economic challenges go beyond the country's meager productive capacity and shortage of foreign exchange. The Cuban government also faces severe fiscal difficulties along with deficient, crumbling housing stock, urban construction and infrastructure. In Havana, apart from tourist venues and the enclaves of foreign diplomats, Cuba shows no sign of having the resources to maintain, fix, or replace buildings or infrastructure of any kind. The streets, sidewalks, and structures of all kinds are in grave disrepair, many simply unusable. Everything in sight needs a coat of paint or plaster. Water and electricity shutdowns occur regularly. Streets are barely, if at all, lit at night. For most Cubans, access to Wi-Fi is limited to a few public parks, where multitudes of young people pay two dollars an hour (or nearly ten percent of the average monthly wage) for access to unreliable signals. True, Wi-Fi use doubled in the past year, but Cuba, which boasts one of the best educated populations in Latin America, still has, by far, the lowest rate of internet access in the hemisphere.

Public services generally—including schools and medical facilities, for which Cuba has long been admired and praised—are deteriorating. Many hospitals require patients to bring their own bedclothes, and often food and medicines as well. The quality of education has slipped as well.

Cuba does not conduct household surveys or publish data on family income and wealth, so there is no real information on the extent of poverty and inequality or their evolution over time in the country. But no one disputes the fact that the salaries of teachers, doctors, and the great bulk of other state employees (which account for about 80 percent of the work force) are extremely low. Families without supplemental incomes, from remittances or unauthorized employment, for example, live in poverty and struggle to make ends meet. The elderly and disabled are in particularly harsh situations. A shock to the economy—for instance, from cutbacks in financing from Venezuela—could end up leaving a sizable share of Cuba's population destitute.

Powerful demographic shifts are another visible threat to country's economic future. Cuba's birth rate is among the lowest of the world's developing nations, while large-scale emigration from the island has continued unabated for many years, and is now accelerating. The result is a constantly shrinking work force and an increasingly aged and dependent population, which will translate into still lower productivity and growth. Adding to the damage, many of those leaving are trained professionals. The Cuban government's recent ban on the free travel of medical doctors is evidence of the problem—which is aggravated by US immigration policies which provide special, favored treatment to Cuban immigrants and openly recruit Cuban doctors working overseas.

The US Economic Embargo

There is no question that new and substantial inflows of foreign investment and financing are needed for the island's economy to begin to grow and prosper. Without foreign capital, appropriately invested, economic activity of all sorts will remain precarious, and the country largely impoverished.

Most analysts, regardless of political leaning, also agree that Cuba's economy will remain stifled until the US embargo is lifted. Despite the easing of many restrictions in the past year, the embargo remains a sizable barrier to the island's trade and growth and contributes a great deal to the widespread poverty on the island. Ending this economic quarantine, will give Cuba access to the US's immense markets and huge capital resources. US suppliers would be able to sell to Cuba on credit. The way would be opened for a likely surge in American tourism. A regularized economic relationship with the US would also make Cuba more attractive to investors from other nations. Cuba and its trade and investment partners would be able legally to use the US dollar in their transactions. International investors, bankers, and traders, who today are apprehensive about violating US laws, would be assured that they could transact business with Cuba without the risk of triggering US sanctions.

However, it is also true that even if the embargo remains in place, its restriction will likely be substantially eroded in the coming period. Limits on remittance transfers will continue to recede in face of demands from Cuban-Americans seeking to assist relatives on the island. Curbs on US travel to the island will continue to fade. Lobbying campaigns by the American businesses should steadily, even if gradually, expand access to Cuban markets for US goods. Just this past month, agreement was reached to begin regularly scheduled air travel between the two countries, allowing for more than 100 flights a day. The first US-owned factory, producing agricultural machinery, has been given authorization to open in Havana. US and Cuban banks can already do business together, and ferry service between Havana and Miami is likely to begin soon. Negotiations have begun in order to settle the financial claims of US citizens on the Cuban government.

Many Cubans are convinced that President Obama, by decree, can undo most, if not all, of the embargo's constraints—and they can cite a number of US attorneys to support their conviction. But there is also considerable legal opinion that the US president has done almost all that is allowed by law, and that a further easing of the embargo will require Congressional action (which Obama has called for on a number of occasions). Moreover, how the president deals with the embargo is not merely a matter of legal interpretation. Politics are centrally involved, and the embargo remains a crucial part of ongoing US-Cuban negotiations.

Opposition to the shift in US-Cuba relations has so far been minimal. The fact that it has not been an issue at all in this year's US presidential campaign strongly suggests that the changes that have taken place in the past year are probably irreversible. Yes, the next US president, who is scheduled to take office in ten months, will have the authority to undo the new Cuba policy. In practice, however, such a turnabout is unlikely. It would, first of all, be resisted by many Cuban-American families and many in the US business community, who are now clamoring for broader openings. Around the world, the US would be viewed as wavering and indecisive. Confidence in US commitments would decline, and US credibility on foreign policy would be diminished.

But no matter how difficult it will be to reverse the progress to date, the path toward full normalization could become steeper and more challenging in the coming period. What does seem certain, however, is that the embargo's demise, when it occurs, will provide a boost to the Cuban economy and improve the lives of most Cubans. It may also help to avoid a possible economic crisis on the island, which would present Washington with a complicated set of choices about how to respond.

Humanitarian grounds alone should be sufficient justification to end the embargo's commercial restrictions on Cuba—particularly since the embargo has never succeeded in advancing any US interests or goals. But regardless of who the next president is or which party controls Congress, the Cuban government's own advances toward economic and political opening will be crucial factor in US decision-making regarding the embargo. Respect for human rights, the rule of law, and democratic principles will remain priority objectives of US Cuba policy—and Washington will keep them at the center of continuing US-Cuban talks. Obama himself has made this point on numerous occasions.

Cuba's Economic Agenda

No one can forecast the reaction of the Cuban government to the end of US economic restrictions. It may encourage the government to accelerate the pace of its reforms, which could give considerable new impetus to the economy. But it could, just as well, by providing a measure of relief on the economic front, give the government breathing space to further postpone needed changes. The government remains opaque on issues of economic reform, as well as on matters of politics. Castro and other authorities say, in a somewhat contradictory fashion, that they are embarked on an effort to modernize and up-date the Cuban economy, but that they will not alter the fundamentals of its socialist system.

What is clear, however, is that Cuba will get the full payoff from the embargo's removal only when the government revamps its economic policies and practices. Indeed, without a substantial reform agenda, Cuba's economic prospects, regardless of the status of the embargo, will remain bleak. To be sure, in the past half a dozen years, the Raul Castro government, has adopted a number of reform measures, which have been welcomed by most Cubans—but still widely viewed as insufficient.

The Castro reforms have led to a growing private sector in Cuba. More than a million Cubans, about 20 percent of the workforce, are today self-employed or working in private businesses or cooperatives. No one is yet quite sure how vibrant this independent economy is, however. With statistics extremely limited, the evidence is mostly anecdotal. Clearly, there are many encouraging success stories, but the survival rates and profitability of new enterprises are unknown. The great majority of businesses has only one or two employees and faces a variety of problems—including the lack of wholesale markets, heavy taxes, and burdensome and uncertain regulations.

Building a private sector—or better, creating conditions for the emergence of a private sector—is only one of the many challenges confronting Cuba. Many other wrenching changes will be required. While disagreements have not all been resolved, a convergence is forming among economic analysts (Cuban and foreign) on the fundamental adjustments needed to attract investment and spur growth in Cuba.

- Mainstream economists tend to assign highest priority to replacing the country's dual exchange rate with a single-valued currency. The current exchange system has created enormous inefficiencies and distortions in the economy. It encourages imports, rather than production at home, because those enterprises that are allowed to purchase dollars or other hard currencies can do at extremely low rates. The earnings of local producers, at the same time, are severely constrained by the low prices they can charge for their

goods, and the difficulties they face trying to import machinery or inputs. The problem for the government is that there is no simple, fair way to unify a currency. It invariably brings high costs to some, and huge benefits to others.

- Cuba's extremely limited and badly rundown capital stock and infrastructure, as suggested earlier, is another daunting obstacle to the island's development. Roads, bridges, ports, electric power, water supply, sanitation, internet, and virtually all other elements of Cuba's infrastructure need to be repaired, rebuilt, or considerably expanded. This will require an enormous investment, a large share of which will have to come from outside the country.
- Another crucial priority is to end the government's highly centralized control over the economy, and give government agencies and state-managed companies, as well private investors and entrepreneurs, greater autonomy in their operations. The Cuban state, in short, overregulates the economy as a whole and imposes excessive controls on virtually every sector and company. It sets goals, prices, and salaries, and can and often does intrude on the daily operations of both small and larger firms.
- A related measure is the adoption of rules and regulations for the economy that are transparent and consistent, and cannot be arbitrarily interpreted or altered. Private investors, foreign or domestic, big or small, need to be assured that rules will have some permanence, that the government cannot change them at will. And those contracts will be respected. Ideally, independent mechanisms, similar to a judicial procedure, would be established to resolve commercial disputes arising between central government agencies and enterprises, whether private or state run. .
- The Cuban government needs to improve its collection, analysis, and communication of economic and social data. Cuba gathers and publishes far less information than most other countries, and fails to follow globally accepted norms that allow for comparative assessments. Indeed, the reports and statistical analyses put out by international institutions, when they include Cuba, have no option but to leave many spaces blank. Under the circumstances, it is hard to be confident of the reliability of the data that the government collects and distributes.
- A final issue that generates considerable discord in Cuba is whether the Cuban government should initiate some form of consultations with the IMF, World Bank and other international and regional financial institutions, and explore the idea of eventually joining these organizations. Today, 188 countries are members of the IMF and World Bank; Cuba is one of only eight that have remained outside. Many in Cuba deeply distrust these institutions and are wary of their prescriptions, which they believe have proven disastrous for some economies. They are often portrayed as instruments of the US power, and thus as threats to Cuban sovereignty and its socialist order. But even those Cubans who oppose membership in IMF and other international financial organizations acknowledge that they could provide access to needed capital, particularly for infrastructure, and might be a source of useful advice on some issues. Engaging these institutions will require the Cuban government to create a technically competent ,

reasonably autonomous, agency (as discussed above) to assemble and analyze a far wider range of data than is now available on the Cuban economy

The central theme of almost every item on the reform agenda is the need for the Cuban government to give up a substantial measure of the control it now exerts on Cuban economic activities. So far it has shown little willingness to loosen the strings and allow foreign investors and Cuban workers, professionals, and business owners the opportunity to manage their own affairs, even to a limited extent.

For sure, this is not the best of times for Cuba to initiate a massive reform of its economy. Its largest source of external support is likely soon to dry up and, until the US embargo is lifted, no other country can begin to replace the revenue stream from Venezuela. The nations of Latin America and Europe, China, and Japan—all potential investors in Cuba—are confronting their own economic reversals. Just a few years ago, for example, Brazil invested nearly \$1 billion in constructing new facilities and an industrial park at Cuba's Mariel port, but is now in deep recession and desperately short of investment capital. Mexico has signed several commercial agreements with Cuba, but the sharp fall in oil prices have dampened its prospects and sharply reduced its capacity to assist Cuba. The end of the so called commodity super cycle has similarly affected most other Latin American economies.

At least for some time, the future of the Cuban economy, to an important extent, is likely to hinge on two interlinked factors: the pace at which the United States and Cuba fully normalize their economic relationship and on whether Cuba can find ways to work with the IMF and World Bank. Both of these factors, of course, will be affected by the outcome of the US elections in November. However, the primary driver will be the decisions taken by the Cuban government—whether it is ready to move more purposefully toward easing the current constraints on the island's economy and political life. The limited advances to date of Raul Castro's six-year old economic reform are indicative of how difficult it is to bring change to Cuba. Still, there are some reasons for optimism. The moment may be a more politically propitious than it seems. For the first time in memory, the issues are at least being discussed in Cuba and different options may be under consideration.