

The Cuban Economy: A Current Evaluation and Proposals for Necessary Policy Changes

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Omar Everleny Pérez Villanueva*

Abstract

Politicians, social scientists and general readers have noted in both Cuban and international academic forums and periodicals that the well-being enjoyed by the Cuban people in the 1980s has been seriously compromised since the economic crisis of the 1990s. Even for the most skeptical of observers it is clear that this worsening of conditions can be attributed not only to external factors, such as the breakup of the international socialist system, the tightening of the US blockade, and the worldwide economic crisis suffered by underdeveloped countries, but also to internal factors that have kept the country from taking full advantage of the human and material potential available on the island.

Although Cuba is currently experiencing an economic recovery from the collapse in GDP in the mid 1990s following the collapse of its ties with the Socialist Bloc, it continues to maintain high import coefficients due to longstanding structural

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difficulties. The country is highly dependent on food imports as a result of a deficient agrarian policy. It imports energy to a lesser but still significant extent, and it still requires many intermediate inputs for the productive process. Cuban industry and agriculture continue to suffer from low levels of efficiency and productivity.

Institutional reforms in the mid-1990s allowed the population to diversify its sources of income. The growing role of market forces in the once state-dominated economy and the strategies being pursued by people for generating income have led to slow, but growing, social differentiation. This process continues, despite measures taken to counteract it through different programs related to the so-called Battle of Ideas.

The duration of the Special Period points to the contradiction between time elapsed in the development of social processes and time as experienced by real human beings. Addressing the social inequalities unintentionally generated over the course of the Special Period, as the country attempted to implement profound and necessary economic changes with the least possible social cost, should be a priority.

To prepare for the challenges that the country will have to face in the future, we will analyze the economic situation in Cuba using a set of indicators that will tell us about the current economic state of the country and about the social and economic well-being of the Cuban people in the present and recent past.

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The Cuban Economy: A Current Evaluation and Proposals for Necessary Policy Changes

Omar Everleny Pérez Villanueva¹

Politicians, social scientists and general readers have noted in both Cuban and international academic forums and periodicals that the well-being enjoyed by the Cuban people in the 1980s has been seriously compromised since the economic crisis of the 1990s. Even for the most skeptical of observers it is clear that this worsening of conditions can be attributed not only to external factors, such as the breakup of the international socialist system, the tightening of the US blockade, and the worldwide economic crisis suffered by underdeveloped countries, but also to internal factors that have kept the country from taking full advantage of the human and material potential available on the island.

Although Cuba is currently experiencing an economic recovery from the collapse in GDP in the mid 1990s following the collapse of its ties with the Socialist Bloc, it continues to maintain high import coefficients due to longstanding structural difficulties. The country is highly dependent on food imports as a result of a deficient agrarian policy. It imports energy to a lesser but still significant extent, and it still requires many intermediate inputs for the productive process. Cuban industry and agriculture continue to suffer from low levels of efficiency and productivity.

Institutional reforms in the mid-1990s allowed the population to diversify its sources of income. The growing role of market forces in the once state-dominated economy and the strategies being pursued by people for generating income have led to slow, but growing, social differentiation. This process continues, despite measures taken to counteract it through different programs related to the so-called Battle of Ideas.²

¹ The author would like to thank the David Rockefeller Center for Latin American Studies at Harvard University for support in the preparation of this study.

² The Battle of Ideas is a campaign that was launched in Cuba during the dispute with the United States over the custody of Elian González. Since then, the campaign has continued to focus on strengthening social programs in Cuba with a strong emphasis on Cuban youth.

The duration of the Special Period³ points to the contradiction between time elapsed in the development of social processes and time as experienced by real human beings. Addressing the social inequalities unintentionally generated over the course of the Special Period, as the country attempted to implement profound and necessary economic changes with the least possible social cost, should be a priority.

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Macroeconomic Performance

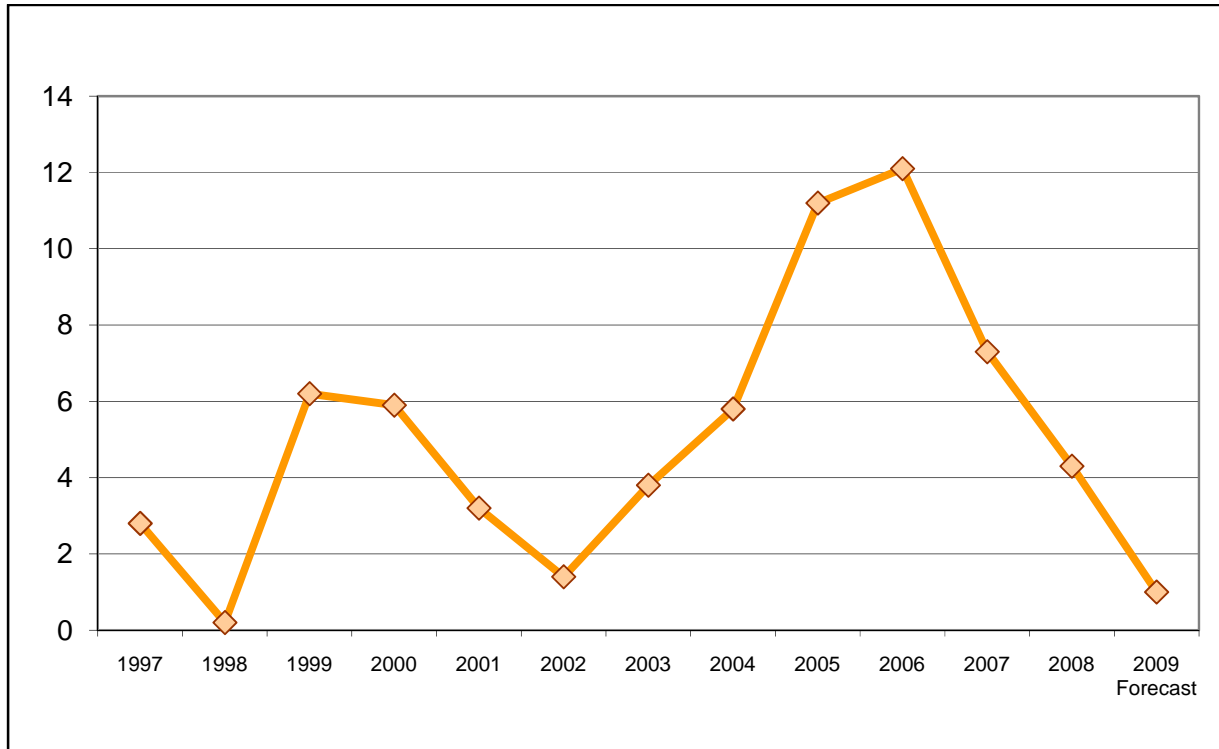
The Cuban economy grew rapidly between 2001 and 2007. During this period the Gross Domestic Product (GDP) grew at an average of 7.5% per year at the constant prices of the base year 1997. From 2001 to 2003, however, it grew at an annual rate of just 2.9%, while between 2004 and 2007 GDP grew at a yearly average of 9.3%. This difference was partially due to a new methodology⁴ for calculating GDP and also to very favorable growth in the export of professional services in the latter period. In 2008 and 2009, however, a significant deceleration of the pace of economic growth took place that alerted the government in 2009 to the fact that it was necessary to outline a new program of economic adjustment, with a new consideration for the population's well-being.

³ This term is employed in Cuba to denote the period of economic adjustment that was sparked by the collapse of trade with the Socialist Bloc. It is considered to be continuing up to the present-day.

⁴ A new methodology for calculating GDP was implemented in 2000. The revised GDP calculation includes estimates on the share of state spending on public health care and education, as well as subsidies for transportation and food rations.

Figure 1: Growth of GDP

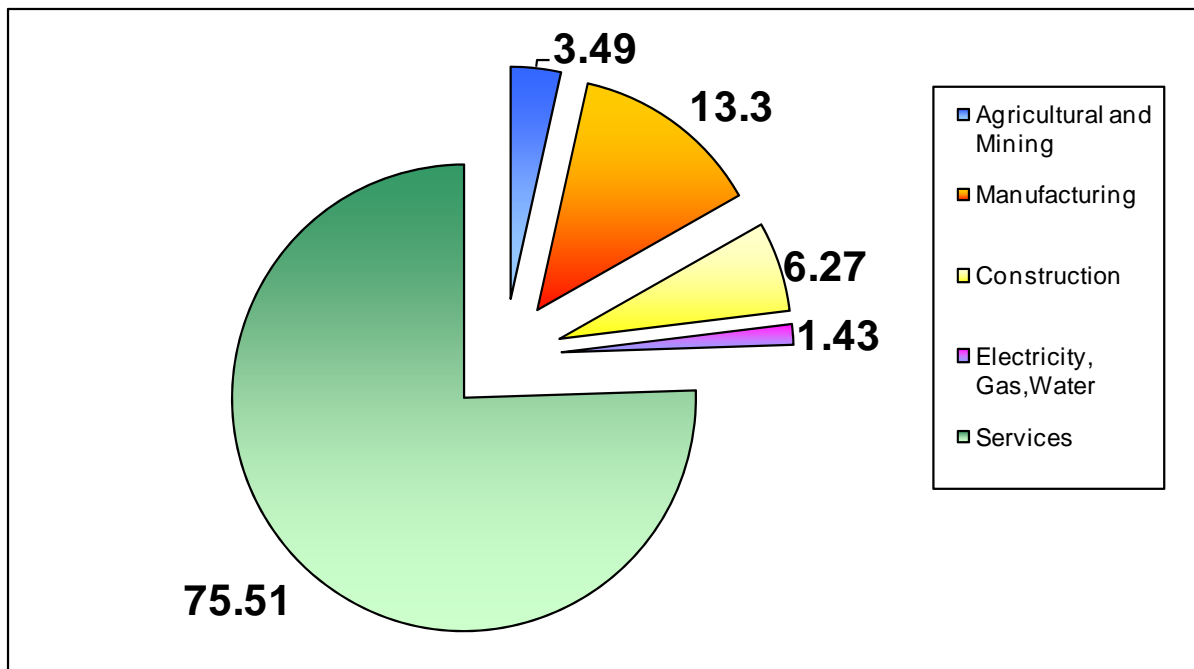
(Annual percentage growth rate at constant 1997prices)



Source: National Office of Statistics, Statistical Yearbook of Cuba, various years, Havana.

The share of GDP derived from the agriculture, construction, and transportation sectors has diminished. In contrast, the share of services has increased significantly. In 2008, the service sector represented 75.51% of GDP.

Figure 2. Structure of 2008 GDP in percentages.



Source: National Office of Statistics, Statistical Yearbook of Cuba, Havana

The Cuban state's allocation of available resources reflects the priority that it has accorded to social programs within its overall development strategy. Nevertheless, while gross fixed capital formation was 60% greater in 2006 than in 2001, its share of total spending has decreased to less than 10% of GDP from over 30% in 1990.

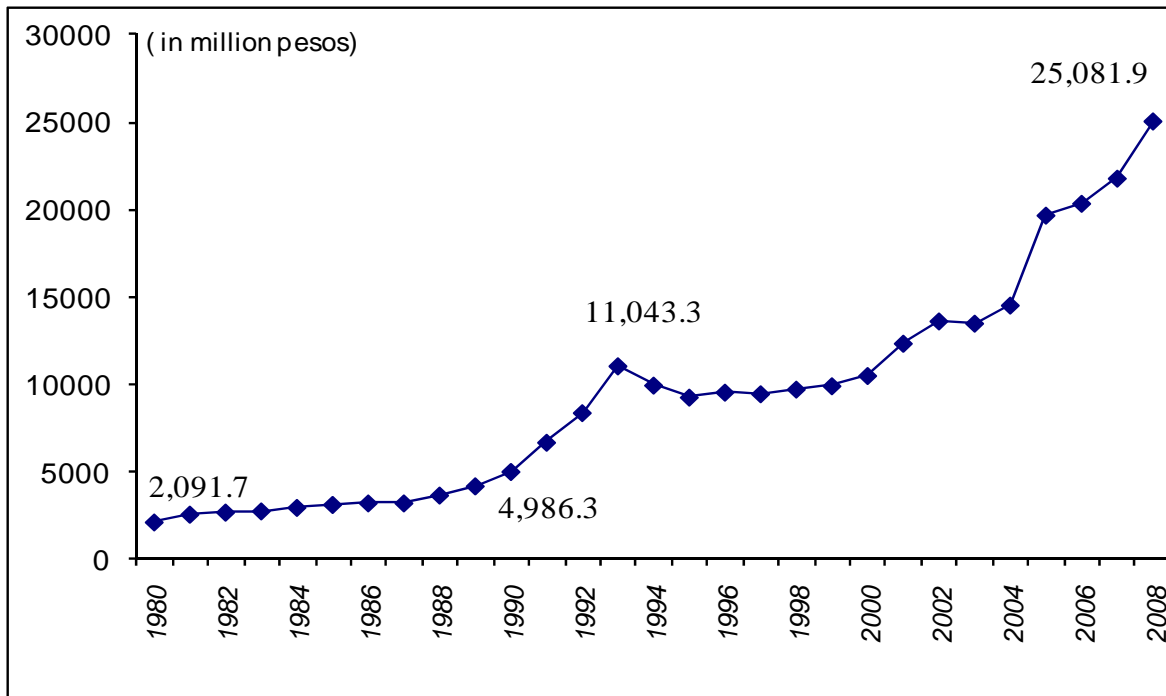
The growth of GDP has been accomplished without sacrificing macroeconomic equilibria reached since the middle of the 1990s. The fiscal deficit has been kept to a controllable size (about 3.2% of GDP), but in 2008 was about 6.7% of GDP. Monetary policy has succeeded in reaching the key target of achieving the stability of the CADECA⁵ exchange rate. At the same time the monetary liquidity of the population reached extraordinary levels at over 25 billion pesos in 2008, 40% of GDP

The Cuban economy has had to develop in the face of adversity including serious droughts, violent hurricanes, difficulties in generating electricity, and increased pressure from the United States that included further restrictions on travel by Cuban citizens to that country,

⁵ CADECA is the official currency exchange agency.

stricter limitations on remittances to Cuba, and most recently, attempts to seize Cuban assets held outside the country.

Figure 3. Cumulative Liquidity



Source: National Office of Statistics, Statistical Yearbook of Cuba, Havana

Cuba continues to suffer from structural problems in its economy, including a scarcity of hard currency earnings, distortions in its relative pricing system resulting from an overvalued official exchange rate, a lack of convertibility, monetary duality, segmented markets, poor performance in the sugar industry and in agriculture, and inefficiency in public entities. President Raúl Castro has commented on these problems in numerous public statements.⁶

Positive results were reached in certain sectors such as petroleum and gas extraction. Oil production has increased six-fold since 1990. Gas production was negligible in 1990 and has now reached over a million cubic meters. These accomplishments have allowed Cuba to reduce

⁶ Speeches by Raul Castro on July 26, 2007 in the province of Camaguey and on February 24, 2008 at the National Assembly of the People's Power Assembly in Havana.

its oil imports at a time when prices on the international market are increasing rapidly. The petroleum agreement with Venezuela has also helped to mitigate the inflationary price spiral of the crude oil Cuba imports.

In general, manufacturing production has decreased steadily. The sector contributed 13.3% to GDP in 2008, but performance varied dramatically among the different industrial sectors. Nickel, beverages, spirits, tobacco products, and some other manufactures increased, while sugar production plummeted with harvests less than 15% the size of those at the beginning of the 1990s.

Only 1,300,000 tons of sugar was harvested in 2008 due to the unavailability of necessary resources for even the basic needs of the sugar-based agro-industry, a lack of stimuli to agricultural and other producers, and the low priority accorded to the sector during the 1990s. A process of decapitalization had unfavorable repercussions for crop yields and sugar production, leading to significant reductions in sugar exports, and reduced flows of hard currency and financing that affected the national economy. The closing of half the sugar refineries in the country left 100,000 people out of work and required a difficult retraining process. The situation with the unemployed and underemployed former sugar workers has still not been definitively resolved. New sources of productive employment for these workers must be found in the near- to mid-term.

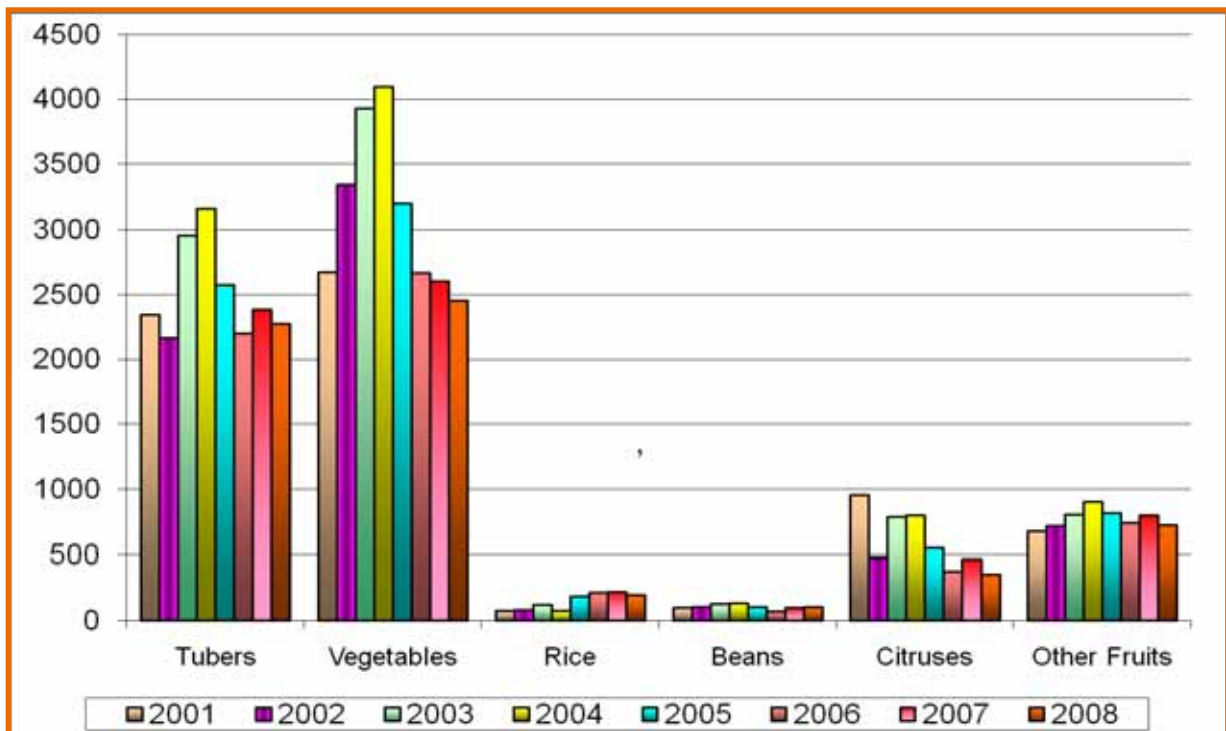
Agricultural production and the sale of products in agricultural markets are important to the population's consumption of food products and thus to its well-being. Agricultural production has continued to decrease in recent years. The proportion of agriculture in the GDP was less than 3.49% in 2008 due to the sharp decline in the production of cane sugar, a continued decline in the number of livestock, and stagnation in non-sugar agriculture. While acknowledging the reality of tangible problems including shortages of financial and material resources, we must recognize that there are organizational and institutional problems in the Cuban economy that have had a significant negative impact on the economic performance in these areas.

The economic reforms of the 1990s enabled some state agricultural enterprises to be grouped into somewhat more flexible Basic Units of Cooperative Production (*Unidades Básicas de Producción Cooperativa*), but the highly centralized environment in which they functioned discouraged producers and impeded any increase in yields or production. The availability of external supplies was inadequate and the State procurement and distribution enterprise (*Acopio*)

sets such low prices for agricultural products that they are sometimes below the cost of production.

Figure 4 illustrates that the production of *viandas* (potatoes, sweet potatoes, yuca, cassava, plantain, and others) and of other vegetables basic to the Cuban diet (tomatoes, cabbage, lettuce, onions, and others) decreased at a time when food prices were rising rapidly worldwide.

Figure 4. Agricultural Production (thousand tons)



Source: National Office of Statistics, Statistical Yearbook of Cuba, various years, Havana.

There were significant price decreases in agricultural markets between 1994 and 1996 as the opening of these markets hampered the price speculation that had prevailed for agricultural goods on the black market. In addition, money became scarce and production increased and then stabilized. In the last 10 years, however, there has been no tendency for prices to fall in keeping with the decreased purchasing power of the population, especially for those households dependent on salaries from the state-dominated sphere of the economy. In order to lower consumer prices, it has become necessary to seek alternative means of increasing agricultural production

Activity has also decreased in the livestock sector, particularly regarding cattle. Decreased volumes of feed deriving from sugar cane led to an unfortunate dependence on imported animal feed. There were droughts in the eastern provinces, herd management was deficient, and there were structural weaknesses in overall organization.

The UBPCs orientation toward raising livestock has not demonstrated significantly improved results. New agricultural methods clearly call for new management methods and mechanisms. Existing mechanisms with a centralized and vertical orientation should be replaced by economic-financial instruments. The State should limit itself to outlining policies, establishing and implementing appropriate instruments to execute them, guaranteeing the availability of necessary scientific-technical services, and protecting the natural environment, while leaving decision-making on management and production issues to microeconomic subjects.

Poor performance in the agricultural sector has negative impacts on the country's fiscal gap and trade deficit. For example, the amount of food that had to be imported in 2008 to reach a daily consumption level of 3,287 kilocalories and 89.9 grams of protein per person was greater than the amount imported in 1989.

Although Cuba overcame the crisis of the first half of the 1990s, the years leading up to 2008 were characterized by a deficit in the supply of available food for consumption and demand. While the overall nutritional state of the population has improved (with the exception of dietary fat intake, which is not a surprise given that oils are mostly imported and charged to consumers in convertible Cuban pesos), it is notable that certain levels of malnutrition have also been found to be present in some households.

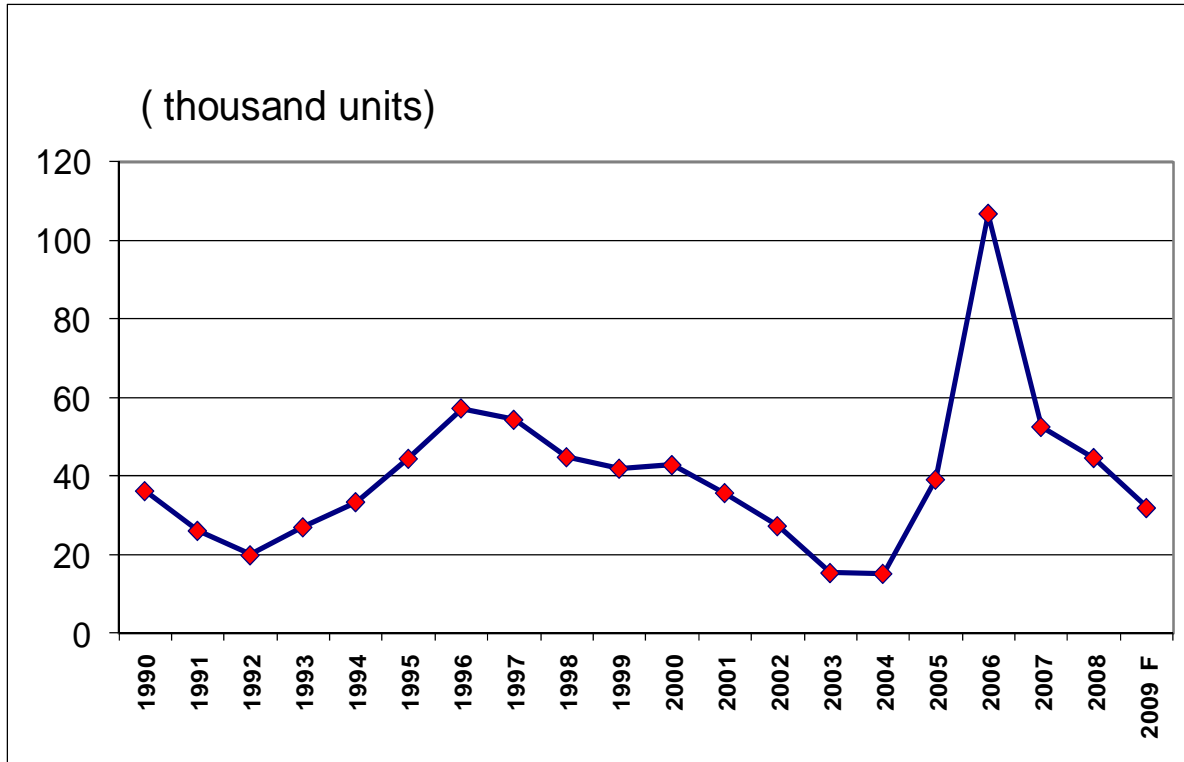
Low levels of agricultural production and the resulting increase in food imports in an environment of rising commodity prices mean that the country's agricultural strategy and policies should be reconsidered. A way must be found to stimulate development appropriate to the economic environment and new ways must be found to unleash the potential of the labor force. Some modifications were made to agricultural policy in the first half of 2008. Among other measures, an incipient market for agricultural inputs has been established, land and livestock have been provided to private producers, and municipal enterprises have been strengthened, which is to say that the degree of verticality of decision-making has been reduced.

Construction has increased enormously in recent years. For example, growth in the sector was 37.7% in 2006, concentrated in the areas of petroleum, electricity, and tourism infrastructure, and in the areas prioritized by the government as part of what is known as the Battle of Ideas. These areas included housing, school, and hospital construction and the repair of existing schools and hospitals. By 2007, however, the value of new construction had decreased by 9% as investment contracted due to a discrepancy between the resources allocated to projects and the capacity to carry them out.

Although substantial resources were invested in the 1970s and 1980s to expand the supply of housing, the housing deficit was still acknowledged to be a problem in 1989 and the crisis of the 1990s contributed to the further deterioration of the existing housing stock. In 2001 and subsequent years, there has been a sharp drop in housing construction due to the allocation of resources to the recovery of housing damaged by multiple hurricanes and to other priorities. It has been clearly demonstrated that the construction of new housing will not by itself resolve the housing question. Resources must also be allocated for the maintenance of the existing housing stock in Cuba.

The state accorded increased priority to the construction of new housing in 2006 due to the deterioration of existing housing stock and the housing deficit that had accumulated over several decades. A program was established for the construction of 100,000 housing units annually, emphasizing self-construction versus state-led housing development. This program was found to have many deficiencies and in fact has since been reduced in scope. Its shortcomings should be addressed in the short-term.

Figure 5. Completed Houses



Source: National Office of Statistics, Statistical Yearbook of Cuba, Havana

Problems with public transportation have had a negative influence on the well-being of the Cuban population. Insufficient capital formation in the sector led to a rapid deterioration of equipment. A large-scale investment program outlined in 2007 has permitted the importation of buses and other transportation equipment from the People's Republic of China. This should be reflected in very favorable improvements in 2008.

To summarize, Cuba's GDP is continuing to grow rapidly, but due to a deterioration in certain sectors, the economic recovery process is not rapid enough to regain the levels of economic well-being that existed prior to the crisis years in the early 1990s. New policies are needed to stimulate economic reactivation and increase productive dynamism while maintaining macroeconomic stability in order to ensure the sustainability of the advances in social equity and the provision of basic services that have been sustained by the Cuban government over the last decade.

In 2008 there were signs that the government was willing to take steps to make Cuban socialism viable, including the elimination of certain prohibitions. These changes included the legalization of the sale of certain consumer items, including computers and DVD players, and the granting of access to services, including cellular telephony, that were previously reserved for enterprises, the diplomatic sector, and foreign citizens. The restriction on Cubans staying at hotels built to serve the needs of international tourism has also been lifted. In addition, Resolution 9 of the Ministry of Labor and Social Security introduced measures to allow for salaries and wages to be set with more flexible ceilings and caps. Legal Decree 260 of 2008 concerning the work and salaries of retired teachers and professors provides incentives to draw them back to the classroom, and Decree 259 allows idle land to be assigned in usufruct to private parties.

The Evolution of the External Sector

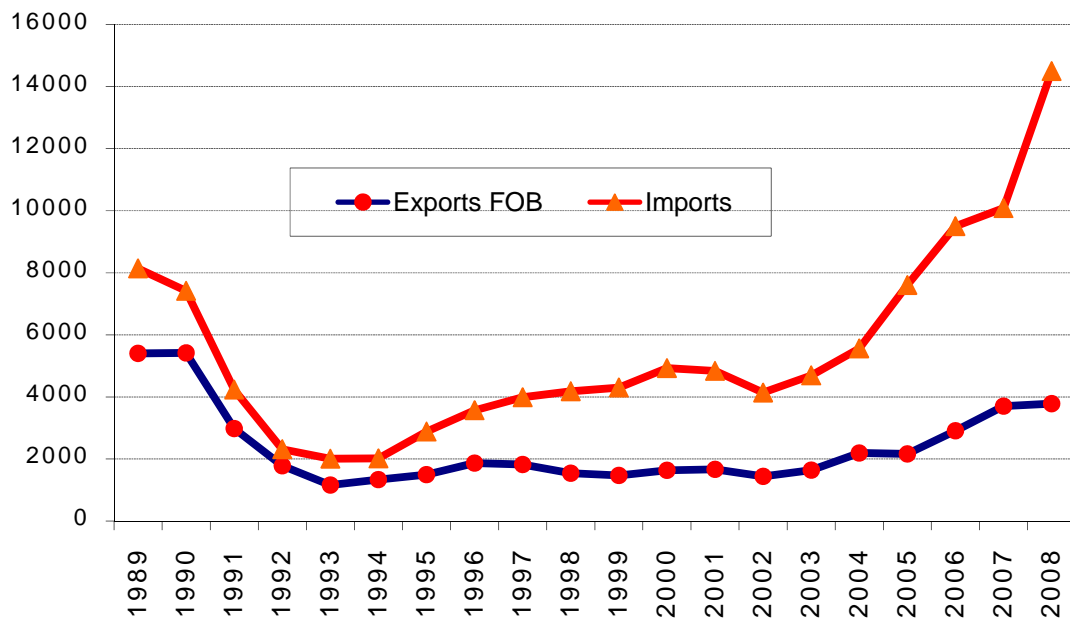
The characteristic current accounts deficit in Cuba's balance of payments was transformed into a current account surplus in 2004, but overall balances have continued to fluctuate. In 2005, the surplus was US\$140 million. Although data has not been released for 2008, the surplus obtained in the commercial balance of goods and services in 2007 indicates that the results may be positive, but in 2008 the results were very negative. The factors that have driven this turnaround include the increased export of professional services, specifically those of health workers deployed in developing countries on medical missions, and the receipt of remittances, widely estimated to be between US\$ 900 million and US\$1 billion. Indeed, the service sector was the greatest generator of export income beginning in 2004. There were significant qualitative changes within the sector as the value of knowledge-intensive services overtook the value of the tourist sector in generating income.

In contrast to sugar exports, nickel exports have increased significantly in the last three years, with both increased production and higher prices. Foreign sales of nontraditional high value-added products have also increased, including in the areas of biotechnology, pharmaceuticals, and advanced medical and diagnostic equipment. New markets have been found for these products and about 200 of them have been licensed by health authorities in 52 countries. Nickel has continued to be Cuba's most important export in 2008 due to high prices on the international market. The export of pharmaceutical and biotechnology products also took off. The current structure of export products indicates a significant transformation. Medicines constitute an important export subsector while the sugar subsector has become less important. Nonetheless, sugar remains one of the products for which Cuba has the most productive potential.

The recovery in the export sector is undeniable, but the value of exports in 2008 was still 31% less than in 1989. In contrast, imports have grown rapidly, exceeding their 1989 levels by 75% in 2008. In 2008, most of the commercial trade in merchandise was with Venezuela, China, Canada, Spain, the United States (due to Cuba's food purchases), and some European countries. This was a structural change in the composition of trade by regions and countries compared to the early years of the 1990s.

Cuba has recovered its ability to pay for imports and is now purchasing goods abroad at a significant and increasing rate. The structure of these imports does not favor capital goods, however, with the exception of gasoline- and diesel-powered electric generators and similar items. Instead, imports are concentrated in the food sector (including many products that could be produced domestically) and in intermediate goods. Food imports remain high due to the insufficient performance of the agricultural sector, as discussed above, and imports of raw materials and industrial equipment have increased as a result of the economic recovery.

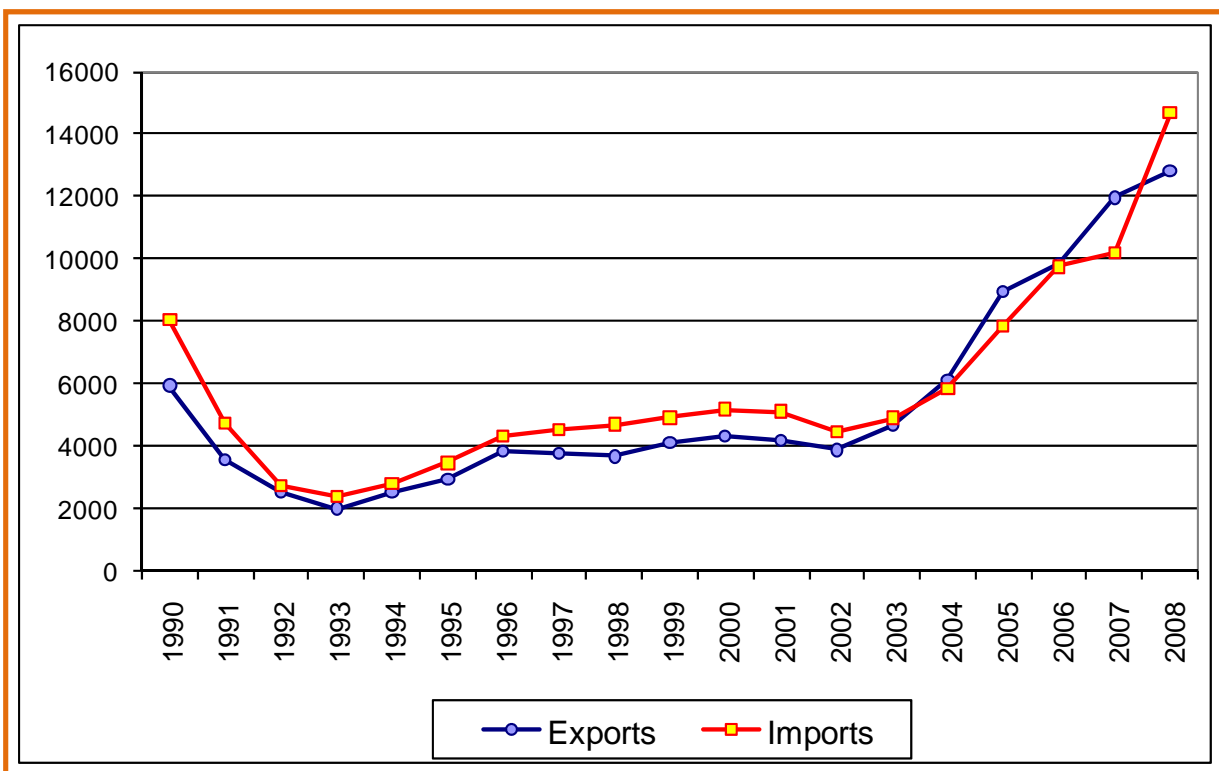
Figure 6. Foreign Trade in Goods (million Pesos)



Source: National Office of Statistics, Statistical Yearbook of Cuba, Havana

This has led to a merchandise trade deficit of about 10 billion pesos, approximately 20% of the GDP. This figure is high, and it could be reduced by increasing domestic production of certain goods currently imported. To do so the Cuban state should give maximum priority to increasing worker incentives, make some necessary institutional changes, and eliminate excessive centralization.

Figure 7. Foreign Trade in Goods and Services (billion Pesos)



Source: National Office of Statistics, Statistical Yearbook of Cuba and other information, various years, Havana.

Income from tourism surpassed US\$25 billion between 1990 and 2007, growing from US\$243 million in 1990 to 2.236 billion convertible Cuban pesos (CUCs) in 2007. More than 7 billion pesos were spent on tourist development during that period. Of this amount, more than 2.3 billion pesos were spent on tourist infrastructure, airport capacity, and new technology for tourist services and telecommunications. Some 24 million people visited the country and the

number of hotel rooms increased from 12,900 to 45,000, almost half of these being administered by foreign hotel companies.

Tourism decreased in 2006 and 2007 for domestic and international reasons. Internally, factors including high prices, management and maintenance difficulties at some hotels, the limited supply of services outside the hotel sector, and the 8% revaluation of the CUC are important reasons for the reduction in the growth rate of the total number of tourists entering Cuba. In addition, external factors such as financial turbulence, slow economic growth in the countries of origin of tourists, and high oil prices leading to increased transportation costs, especially for European tourists, has also had a significantly negative impact. In 2008, tourism increased by about 8.9%.

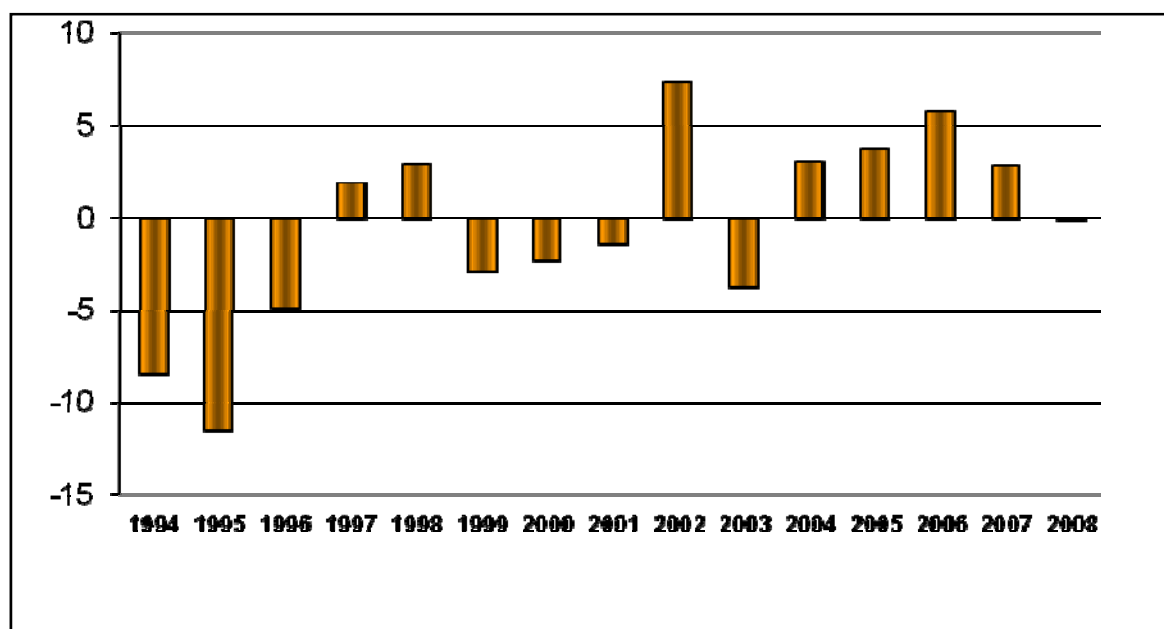
Foreign investment has been concentrated in key sectors such as petroleum, nickel, telecommunications, and tourism. International investment by Cuba has appeared in incipient form, primarily in biotechnology in Asian markets such as China, India, and Malaysia. Venezuelan investment in the Cuban economy has increased in oil, nickel, petrochemicals, and telecommunications.

Cuba's credit capacity is still limited, except with China and Venezuela, the latter within the framework of the Bolivarian Alternative for the Americas (ALBA). This is due not only to Cuba's limited credit worthiness, but also to pressure from the United States government, which continues to apply punitive economic measures against the country.

Prices, Income, and Employment

There was a deflationary episode in 1999-2001, but inflation increased sharply after 2003. The increase in the consumer price index has been driven by the increase in prices in non-regulated markets for essential consumer goods. These include higher prices for some products in the ration stores and agricultural markets, higher electricity rates and gas prices, and the prices of other products including household appliances and some food and personal hygiene items.

Figure 8. Consumer Price Index
(Annual percentage variation)



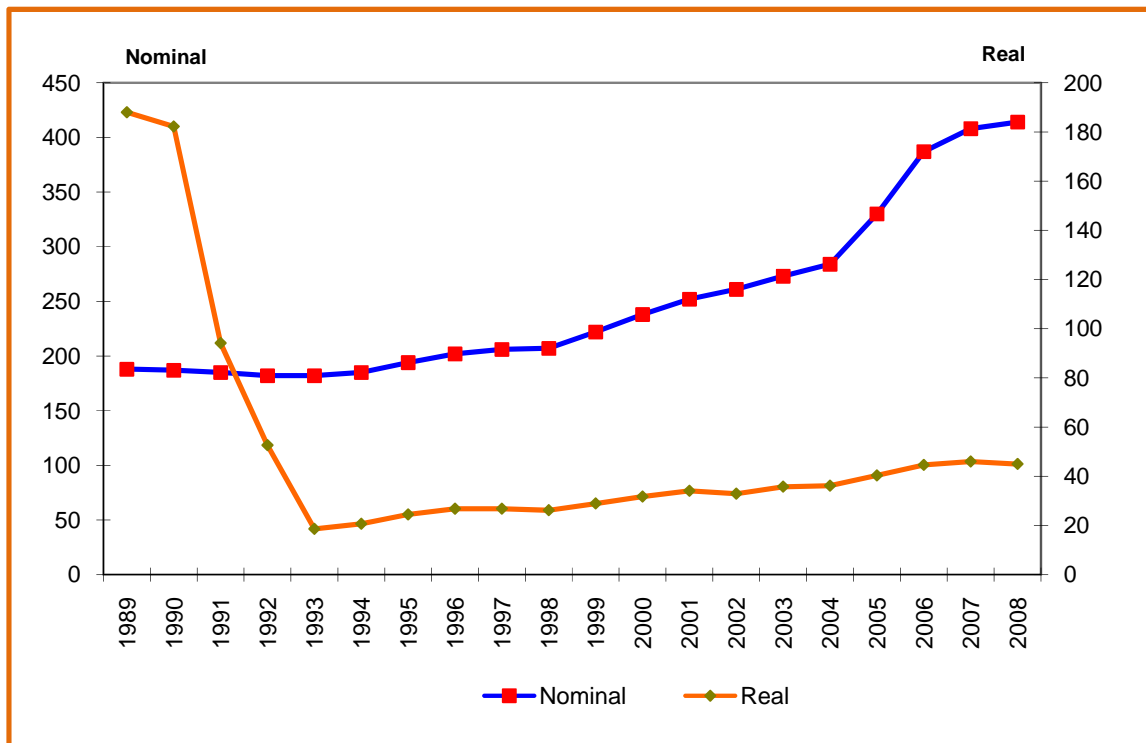
Source: National Office of Statistics, Statistical Yearbook of Cuba and other information, various years, Havana

The evolution of this indicator is seen in Figure 8. In 2008, the inflation rate was 4.9%. One can see that inflation has not been high since 1995; in fact there have been decreases in average prices for some years. In the last period there has especially been a certain pressure to raise prices, with five consecutive registers of more than two per cent, but even so it remains as an average within the margins accepted internationally as low inflation.

The population's income is an important variable since its availability for spending is a necessary precondition for demand, and therefore consumption, in all accessible markets. Nominal income has continued to grow over the period due to the increases in wages for state workers in the public and state enterprise sectors, the growth of some productive activities, the entry of remittances to the country, and other factors. The median nominal salary, which is the most important component of the population's income, has continued to grow over time, reaching 414 Cuban pesos in 2008, a significant increase from the median monthly salary in 1989. However, the increase in the nominal salary has not been enough to overcome the deterioration in real salaries due to the even greater increases in the Consumer Price Index (CPI) over the period. This has created significant problems for the majority of households that depend

on salaries as the most important source of income. It is important to consider real salaries, which were far below those of 1989.

Figure 9. Nominal and Real Median Monthly Salary (Pesos)



Source: National Office of Statistics, Statistical Yearbook of Cuba , various years, Havana; Pavel Vidal, *La inflación y los salarios reales en Cuba*, IPS, Havana.

A salary reform was implemented in 2005 mandating that professional qualifications, education, and knowledge base be taken into account when setting workers' salaries. Raises were most common in state-financed sectors such as health and education. The social security pensions received by 1,468,641 citizens were subsequently raised at an annual cost of 1.035 billion pesos. An additional 257,030 family units comprising 476,500 people began to receive 50 additional pesos in their pensions in the form of social assistance. The minimum salary was raised from 100 pesos to 225 pesos. The total additional expenditure for these measures in 2005 was over 3.4655 billion pesos. These measures alleviated the economic situation of many households in state-financed sectors, as well as in part for retired workers and others receiving

pensions. This is because the increase in liquidity during the period led to new price increases for scarce agricultural and black-market goods because there was no adequate increase in the production or importation of consumer goods. As a result, personal income remains insufficient to cover the necessary purchases of Cuban families due to the elevated prices for food. A portion of the population continues to be unable to satisfy all of its basic needs, especially for food. The relationship between income and consumption is highly distorted.

In order to increase real salaries there must be a greater supply of products available in exchange for the currency in which those salaries are paid or there must be a revaluation of that currency. The policies being implemented at this time, however, have not proven strong enough to stimulate the adequate development of productive forces, i.e. labor productivity.

What might be some of the causes of the current economic situation?

- ✓ As a result of its structure, GDP growth rate still does not allow for greatly increased levels of consumption.
- ✓ Industrial and agricultural productivity and efficiency continue to be low.
- ✓ Due to the low profitability of enterprises, taxes on the sales and circulation of goods (particularly taxes on cigarettes and beverages) represent a larger proportion of state revenues than taxes on the profits of producers. As long as this situation persists neither nominal salaries nor state spending can be increased in a sustained fashion without creating inflationary pressure.
- ✓ The liquidity of the population is increasing, but it is ever more concentrated in the hands of a few and is often held in bank accounts.

The existing monetary duality and payment for consumption in a currency other than the Cuban peso (the proportion of the total consumption of goods and services paid from resources derived either from Cuban convertible pesos (CUC) or hard currency) are excessive in view of the overvalued official exchange rate. This situation has increased social inequality. It should be recognized that a portion of the population's consumption is derived from the access to goods obtained in regulated and rationed markets where prices are quite low or which are distributed without payment. In light of the population's income, these goods are affordable; their supply, however, is limited.

The total volume of remittances has been decreasing as a result of laws passed by the George W. Bush administration. Although it is not possible to establish remittance volume with

any precision due to the different means by which they are sent, it seems clear that they have not decreased very greatly if one uses the continued sales in “dollar stores” (*Tiendas de Recuperación de Divisas* - TRDs) as a measure since these have continued to increase over time.

The official unemployment rate has been low since 2008 at 1.6%, compared to a rate of 7.9% in 1995. However, it should be noted that job creation in recent years has been based on the country’s development strategy of concentrating on the tertiary sector. Since 2002 in particular, job creation has been concentrated in social programs associated with the so-called Battle of Ideas. The fact that less people are working in Cuban industry is symptomatic of the continued paralysis of many activities, reductions in industrial investment, and the lack of necessary hard currency with which to purchase industrial inputs and improve the utilization of existing capacity.

It should be remembered that employment policy itself has contributed to underemployment in many cases. A critical fact underlying many problems is that workers lack motivation on the job due to the time and resources they need to dedicate to securing their basic needs. This significantly detracts from the creative energy that would under normal circumstances be available to them for their official profession. This difficulty is reflected in daily life. Many professionals working in the fields for which they were trained must have a second job to supplement their low salaries and ensure the fulfillment of daily needs. In other cases, individuals simply migrate to work in other sectors where their specialized education plays little role, but where they are able to secure greater economic security. In the worst of cases, individuals seek employment outside Cuba in order to send remittances to their families that remain on the island.

The state should continue to play a leading role in addressing and resolving these problems. While there is confidence in its ability to do so, the potential for family and individual capital should also be recognized to a greater extent. This can happen if recognition of the assets of the households is encouraged and conditions are created for these assets to be utilized within the limits of the law.⁷

⁷ Angela Ferriol, Maribel Ramos, and Lía Añé. *¿Pobreza en la capital ?* INIE- CEPDE/ONE, 2004. Havana.

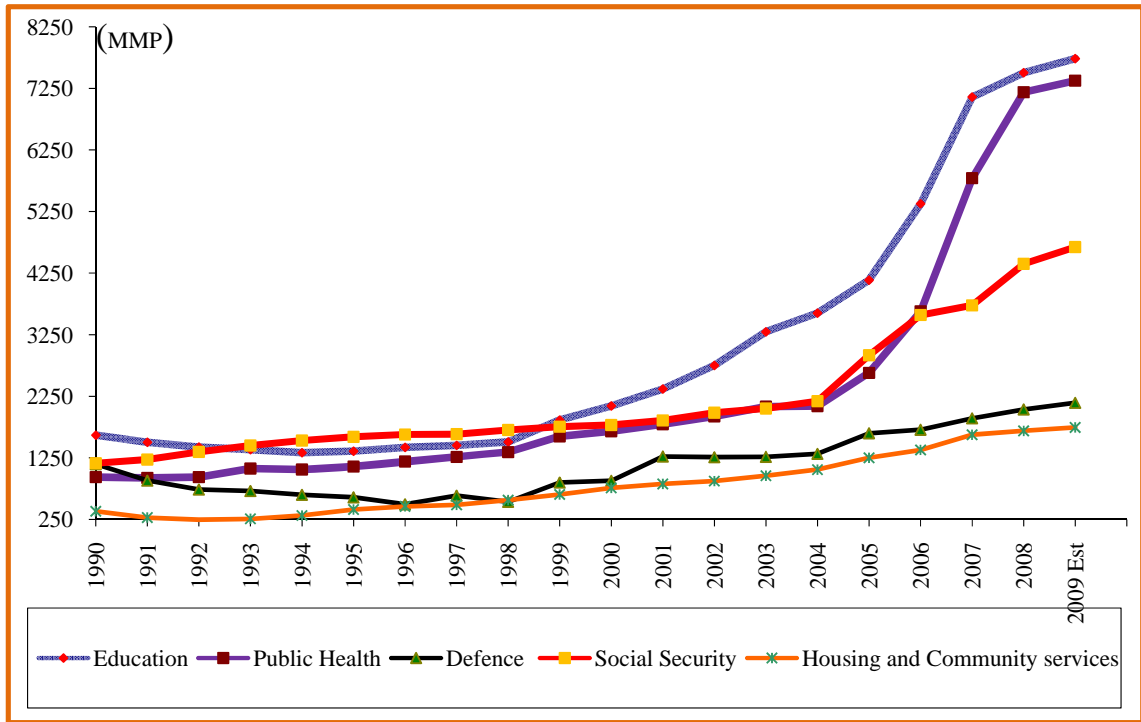
Fiscal Policy

In general, the national budget is the principal source of financing for social policies. The share of the fiscal resources for these policies is designated in the national currency and disbursement of these resources is structured in a decentralized fashion. The use of funds is determined in keeping with the necessities of each region.

The share of government spending allocated for expenditures in scarcer hard currency is structured in a much more centralized fashion. A significant portion of financing for investments in infrastructure and its modernization are also supported by the state budget and to some extent from donations by international institutions. In practice, the degree of centralization of the allocation of resources in hard currency acts to counter the decentralization that is being sought in the financing of policies in national currency based on local disbursements.

The 1990s were characterized by a tendency toward increasing current spending in budgetary outlays despite the economic crisis (Special Period) described above. Many of the increases have been in the areas expected to have the greatest social impact. Cuban economic policy has been directed toward meeting social needs, a goal that received particular emphasis in 2001 and the years that followed. The most important objectives of the national government have included continuation of the provision of free quality educational and health services, guaranteeing the solvency of the social security system, and meeting the needs of senior citizens, the handicapped, and other groups and individuals that have been most affected by the rise in inequality within Cuban society. The government's so-called Battle of Ideas focuses on improving the social policies that have the greatest impact on the quality of these educational and health indicators.

Figure 10. State Budget Performance



Source: National Office of Statistics, Statistical Yearbook of Cuba, Havana

While the Cuban model has always sought to increase social equity, it has focused more on making services available for free than on providing monetary income to citizens to ensure their access to these services. Consequently, universal access to services is a necessary precondition in social policy design. Spending on education has increased over time to improve the quality of services and to meet the needs imposed by demographic growth, and spending on public health has increased in recent years in order to improve levels of health and to ameliorate reduced service quality. Deteriorated facilities including polyclinics, hospitals, and pharmacies have been rehabilitated.

Demography

Demographic studies in Cuba in recent years have characterized the country as being in the advanced stage or culmination of a demographic transition, or possibly in the early stages of a second transition. All studies recognize that the prediction for zero or negative population growth in the next ten to fifteen years has come to fruition sooner than expected. In fact, the

growth rate of the Cuban population has been negative since 2006. Both the reduction in the birth rate and the growth of the over-60 population has accelerated. Sustained emigration is another contributing factor.

The population grew at the very slow rate of 0.2 per thousand in 2005. It decreased by 0.4 per thousand in 2006, 0.2 per thousand in 2007, and 0.1 per thousand in 2008. The share of the population between 15 and 59 years of age as a proportion of the total population has grown in the last fifteen years. This group totaled over 7.7 million people in 2008. The proportion of the population between birth and 14 years of age has decreased as a result of the low fertility rate and the proportion of the population 60 years of age and older has increased. In 2008, about 2.1 million Cubans were between birth and 14 years old and about 1.8 million were 60 years or older.

The key characteristic of the Cuban demographic transition is the aging of the population. The entire society and all its institutions must prepare to deal with this phenomenon, which began in the early 1970s. By the end of that decade the gross reproduction rate had fallen below replacement level and the population of people 60 years and older had surpassed 12% of the total. In 2008 it reached 17.0%.

Other characteristics of the country's rapid demographic change include changes in the population's territorial mobility. Internal migration decreased in the 1990s. However, emigration increased to a rate of over 30,000 people per year for a total of over 200,000 people in the last five years. Population mobility (excluding forced and induced migration) has historically been motivated by a search for opportunities for social reproduction, including factors such as incorporation into the productive process as well as the consumption of goods or services, including services directly or indirectly associated with individual or family self-realization.

The infant mortality rate is an effective indicator for evaluating the performance of the health sector, especially primary care and infant and maternal care. Cuba's infant mortality rate has declined markedly since 1960. In the first decades after that year the decline was attributable to post-neonatal health care, principally the widespread campaigns for vaccination programs against immuno-preventable diseases. Children are now vaccinated against 13 diseases. The infant mortality rate in 2008 was 4.7 per 1,000 live births, confirming Cuba's leading place among Latin American countries and its position among the 30 countries in the world with the lowest probability of death after a live birth.

Principal Challenges and Future Actions

The Cuban economy faces many complex challenges to maintaining its social and economic project and retaining the capacity to increase the well-being of the population. Social and economic distortions and disequilibria must be confronted, and time is short.

- ▶ Internal factors that continue to constrain economic growth must be overcome in the short to medium-term. Among them are financial restrictions on hard currency, which continue to be one of the direct causes of unsatisfied consumer needs.

- ▶ State enterprises are currently subject to an adverse environment related to problems associated with price formation, the official exchange rate, the exchange regime, the centralized authorization required for purchasing, and other planning, regulation, and control mechanisms. Enterprises must achieve a level of efficiency sufficient to be competitive on the international market.

- ▶ The so-called income-consumption model is still seriously distorted as evidenced by its effects on labor motivation. Labor compensation systems must be made coherent to resolve problems in satisfying the needs of workers through salaries, other forms of income, or redistributive channels. Other problems that must be addressed include a reduction in the degree of market segmentation and improvements in the availability and provision of goods and services.

- ▶ The restructuring of the sugar agro-industry remains incomplete. The recovery of production in the industry has stalled, also affecting the production of food on land ceded to growers for this purpose by the Sugar Ministry (MINAZ).

- ▶ There has been no progress toward achieving food self-sufficiency through the improvement of the agricultural management model.

- ▶ Given the cumulative effects of deterioration, greater short-term priority should be placed on addressing the decapitalization of infrastructure and equipment.

- ▶ The productive specialization of the Cuban economy must be changed radically from an economy based on the exploitation of natural resources to an economy based on the intensive use of knowledge. The existence of Cuba's strong potential in knowledge-intensive development does not by itself guarantee the achievement of positive outcomes.

- ▶ The strategic challenge is to grow, as other necessary benefits derive from growth. However, new springboards must be found to increase production. Performance is declining in sectors and activities such as tourism that have been used to increase production in the past.

► Measures should be accelerated to recover previously attained levels of social equity. Despite progress in recent years with measures such as the delivery of household appliances associated with the Energy Revolution, the problem of family income has not been resolved satisfactorily for the majority of Cubans families. Part of the population is still unable to cover all their expenses with the formal income that they receive. As a result they have to seek income from alternative sources or do without a series of goods and/or services.

► While Cuba is an advanced country as measured by social indicators concerning health, education, culture, and other areas, access to certain goods and services in areas including recreation, travel, transportation, and communication is far below the world average for comparable countries.

► Cuba reaped substantial advantages from its relationship with Venezuela in the 2004-2007 period. Nevertheless, the relationship has additional untapped potential to develop reindustrialization programs that would complement and support newly dynamic sectors and allow for the recovery and expansion of sectors that are strategic in light of their impact on the quality of life of the population and on the external sector.

► Cuban state enterprises have not demonstrated a capacity for economic innovation as one of their basic functions. Not only does the economic system suffer from functional deficiencies, but it has reached a kind of dead end from which a substantial transformation will be required if it is to emerge.⁸

► In conclusion, economic reform should be seen as the first of the structural transformations that the country requires. Cuba's economic problem is that the current economic system cannot serve as a starting point for the country's development.⁹

Necessary Policy Changes

The Cuban economy is in urgent need of a profound economic or structural transformation with an emphasis on decentralization. A future strategy must include the decentralization of forms of non-state property not only in agriculture but also in manufacturing and services. The state must play the regulatory role that is appropriate in relation to these economic activities and must concentrate its efforts on the country's fundamentally strategic sectors.

⁸ Monreal, Pedro, *El problema económico de Cuba*, in *Espacio Laical*, publication of the Archdiocese of Havana, April 2008, No. 28, Havana.

⁹ Ibid

Fifty years of Cuban socialism have demonstrated with some exceptions that recentralization and distancing from the market have provoked recessions and other negative economic phenomena. This tells us that we should not necessarily follow this road in the future, and that without altering the socialist project to which many of the Cubans on the island have committed themselves, the state should study a future role for itself regulating enterprises rather than directly administering them.

Agriculture must be granted the autonomy that the new forms of production, especially the UBPCs, call for. Significant amounts of State land should be provided to those who are able to make it productive. Commodity prices paid by the State to small agricultural producers should continue to be increased, and the development of a sugar-based energy agro-industry should be promoted to revitalize the sugar industry and expand the production of derivatives, especially alcohols.

Two steps should be taken as part of a process to eradicate monetary duality. The devaluation of the official exchange rate should be considered and an exchange mechanism should be established for use of the Cuban peso by institutions.

The ration card should be replaced with a new system for subsidizing food that is more efficient and has better distributive effects. The number of ministries should be reduced and the functions and level of centralization in the public sector should probably be changed.

Changes are taking place within an economic policy that seems to have the following priorities: implementing import substitution (particularly in agriculture), stimulating a return of foreign investment, and diversifying international commercial and financial relations. While these transformations and policies are being applied, they will stimulate or motivate new practices within the Cuban system. All evidence is that changes in the Cuban economy are just getting started. The steps taken up to this time represent only a small proportion of the changes required in order to meet the stated objectives and increase the purchasing power of Cuban families.

Finally, there is a need for new reforms to the Cuban economic system in several key areas including measures to enhance the role of the market, increase the degree of regulation of the forms of property, and improve the organizational model of enterprises. In the words of Cuban economist Pedro Monreal, "... in the case of Cuba, a new economic reform is a necessary

first precondition to the other structural changes that the country requires in order for its development to progress.”

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