CUBA—The End Game

Summary of the findings of the 28th Annual Conference of the Association for the Study of the Cuban Economy held on July 26-28, 2018

By Paul Meo (economist retired from the World Bank)

The 28th Meeting of the Association for the Study of the Cuban Economy (ASCE), held in Miami July 26-28, was slightly different from prior meetings. As in recent meetings, an increasing amount of Cuban-based economists and students attended; indeed the two student essay prizes were won by students living in Cuba. The papers presented, and there were many good ones, seemed to sum up the disastrous state of the Cuban economy, its very poor prospects, and then fatalistically concluded there would be little or no light at the end of the tunnel. There was little preaching or suggested reforms; virtually no participant expected further significant political or economic reforms or an economic recovery. Short of finding a new Sugar Daddy like the USSR or Venezuela, one would have to conclude Cuba runs a high risk of becoming a failed state.

But first the present situation. Cuba claims its real GDP grew by about 2 percent last year, but there are strong reasons (see below) to doubt this, and little to expect growth this year. The fiscal deficit seems unsustainable, real salaries remain well below those of the late 1980's--i.e., before Soviet aid ended--and investment remains at just over one tenth of GDP. The steady net disinvestment in many areas--transport, energy, and water/sewerage infrastructure, let alone housing (the deficit is now estimated at over 880,000 units)--continues. Some indices for this year show a distinct decline. Tourist arrivals are down the first half of 2018, and the sugar harvest (which runs from about December to April) produced virtually a record low of only 1.1 million tons of sugar. One of Cuba's best economists noted a continued rigidity of the bureaucracy, reversal of some reforms, and a drop in the expectations of younger Cubans. Some of the recent reforms--freer international travel and house/car sales--seem to have worked; some such as "cuenta propista" (informal, but semi-legal family enterprises) workers and agricultural liberalization have been reversed; and some have either failed--such as the sugar rationalization--or after much talk (currency unification) have never been undertaken. The emigration of so many skilled and experienced workers has had some effect on the quality of teachers, the capacity of government, and the general productivity of the economy. A variety of recent estimates of Cuba's GDP seem to show recent per capita incomes may be either similar to those of 1959, when Fidel first took office, or at most had 1 percent annual growth over the period. Cuba, once ranked in per capita income equal to Spain, Italy, or Argentina, now is about equal to some of the poorest Central
American countries. Surveys show those Cubans born after 1990 now have little
hope of an economic recovery; many want to leave Cuba.

Some details. Pre-Castro, Cuba was the world's largest exporter
of sugar. Indeed, during the 1950s Cuban governments' main concern was to
keep the sugar harvest down, usually below 7 million tons, since after filling its
US quota, too large an excess export amount could depress the world market
price. After Fidel's disastrous effort to produce 10 million tons, sugar output
dropped steadily. In 2002, the authorities decided to rationalize the sugar
industry, reducing mills and cane fields in an effort to increase productivity.
Cuban production initially fell, of course, but productivity and then production have
continued to decline. But 2017/18 seems to have been a nadir; only 1.1 million
tons of sugar was produced, an amount not seen for 100 years. Moreover, since
Cuban consumption is about 700,000 tons, only 400,000 tons were available for
export. The Castro regime has successfully dropped Cuba from the world's
largest exporter to one not in the top twenty; even the US state of Florida
produces far more sugar. Worse has been the productivity of the rationalized
industry. The global average for cane tons harvested per hectare is about
78. Cuba is now averaging 24-42 t/h, even below some poor African
countries. For comparison, the Dominican Republic averages 80t/h, Guatemala
95t/h, and Peru 128t/h. Equally bad, the sugar yield from cane used to be 14
percent; it has now fallen to 11 percent. The Government, for years, has claimed
the poor harvests stemmed from bad weather. This is no longer satisfactory; the
Cuban rationalization effort has been an abject failure, and Cuban sugar is no
longer a major crop.

Equally interesting is the overall agricultural situation. Only 2.7 million
hectares of its 11 million hectares of arable land is now under cultivation. About
80 percent of the cultivated land is by the non-state sector. Although this
includes some cooperatives (58 percent) which were transformed in name only
from state farms, they produce virtually all of the non-cane production. Yet age
of farmers (see below), low wages, and the attraction to tourism jobs have led to
decreasing employment, efficiency, and production. The reforms of over twenty
years ago (higher prices, semi-ownership of some land, private sales, etc.) seem
to have been initially helpful, but some have been reversed. Agricultural
production and employment continues to fall, as does land under cultivation;
agriculture now averages only 4 percent of GDP, and Cuba--which pre-Castro
imported about 30 percent of its foodstuffs--now imports about 80 percent.

Although it is endowed with ample arable land, Cuba--like many smaller
Caribbean countries--moved to a far greater dependence on tourism after the
removal of Soviet subsidies. This has led to a steady increase in tourism, and
that growth boomed after the Obama Administration renewed diplomatic
relations, revised some travel restrictions, and relaxed enforcement of those it
could not revise. Tourist arrivals in 2015 grew in double digits, with steady, if
declining, expansion in 2016 and 2017. The first half of 2018, however, showed a distinct fall, of 5.7 percent. The decline was not only in Americans (a drop of over 23 percent) but Europeans and Canadians as well. Worse, the overall decline included a significant increase in cruiser passengers; the decline in those arriving by air was much steeper, and the government estimates that airplane passengers (excluding tourists of Cuban origin, who often stay with family) spend about US$750/day, while cruiser passengers spend only US$50/day. One participant believed the drop was owed to increasing knowledge of Cuba's very inadequate infrastructure (e.g., electricity stoppages, poor roads, water/sewerage problems, a badly maintained and inadequate domestic airline, poor sanitary and health services) and poor personal service. Hotel and other service employees are paid in pesos equivalent to only US$25/month, although the hotels are charged by the government—which keeps the difference—about US$400/month. Trip Advisor responses rank Cuban hotels an average of 3.5 vs. 4.0 for hotels in the Dominican Republic and well above 4 for Cancun hotels. Moreover, Cuban tourism is highly priced for the services rendered. Each tourist is charged US$200 tax for visiting the country, and good resort hotels during the winter season charge top dollar. He concluded that without major changes, tourism to Cuba would likely stagnate or continue to decline. Another participant agreed with much of the structural issues discussed, but believed that tourism growth would be moderate in the future; that the recent drop was owed to the devastating effect of Hurricane Irma (which hit Cuba's northern beaches hard) and the Trump Administration changes. The owner of a prestigious paladar (private, "cuenta propista" restaurant) in Havana told me her business—of mostly Americans—was down 70 percent. She blamed Irma, the virtual closure of the US Embassy (staff being greatly reduced because of the "strange" ear/brain disturbances encountered), and new US travel restrictions.

While there were fewer sector-specific papers presented on other topics, prior years had detailed the deterioration in everything from the environment to electricity, health services to housing; this meeting had much more macroeconomic analysis. Cuba's GDP estimates have always been a problem for objective economists. First, the methodology has been revised frequently, with no effort to show the effect of the changes. Secondly, for many years Cuba produced estimates of only its Gross Material Product, the macro-output estimate used by the COMECON countries. Thirdly, some years have no reported data. Fourthly, there is the dual currency and exchange rate problem. Finally and recently, Cuba's GDP estimates do not use the UN's System of National Accounts very closely. While value added in visible sectors seems reasonable when compared to production indicators, services are priced by unknown methods and often grow at two-digit rates. There is little doubt Cuba's GDP and its growth rate are grossly overstated.

This situation challenged the economists, who addressed the issue in three ways. One assumed that the service sectors recently grew at the same rate as
the material sectors; a generous estimate for years after 1992/3, when social services seemed to decline after the removal of Soviet subsidies. Then using Cuban GDP data, Maddison and CIA estimates, he concluded that at best per capita GDP grew at an annual average rate of just over 1 percent during 1960-2017. He verified this by comparing his estimate of Cuba’s GDP in 1958 and 2016 to US GDP and thus calculating the relative growth this implied. Another ambitious effort, financed by the IDB, used Cuban product prices compared to American prices and an estimated foreign exchange rate (combining the official with black-market rates) to calculate a PPP analysis. He concluded the UN publication of Cuba’s per capita GDP for 2014 (about US$7,200) should be just over US$3,000. Indeed, his results showed the devastating effect of removing the Soviet subsidies. His estimated per capita GDP for 1985, US$9,516, had fallen by over 60 percent by 1995. His data indicate that Cuban per capita income is likely similar to that of 1959/60. One other participant tried to examine why the recovery since 1993 was so slow. By using the subsidies for state enterprise workers, he was able to estimate the annual number of truly employed state workers added then to the number of "cuenta propista" (own account) workers. Nonresidential investment flows were used to estimate capital stocks. Then, using a Cobb-Douglas production function he estimated total factor productivity (TFP). He found the results reasonably sturdy, since the TFP was not as variable if total employment (including subsidized workers) figures were used. Unfortunately, his TFP was relatively steady; it showed some improvement as "cuenta propista" workers increased but showed little during more recent years. Added to the low capital stock, an expected working-age population decline, and stagnation in "cuenta propista" workers, he foresaw only 2.5 percent GDP growth over the next five years, falling to one percent thereafter. Alternative runs showed the importance of increasing Cuba’s private sector and investment; the former now has almost a quarter of the truly employed work force; increasing it to 35 percent and slowly increasing the present investment ratio from 11.6 percent of GDP to 14 percent would lead to a 12 percent increase in GDP in 10 years. Yet although these assumptions are modest, he expected they would not occur. No-one challenged his expectation. Indeed, based on other challenges the country faces, I found his estimated "no change" growth rate high.

One participant, probably the most knowledgeable expert on Cuban GDP, dissected the UN's Human Development Index. Using per capita GDP, life expectancy, and schooling indices, it purports to show--better than GDP alone--the relative welfare of UN members. By using Cuban data, the HDI occasionally varied incredibly; from 2012 to 2013 Cuba’s HDI went from 5,539 to 19,844! Cuba--where until recently folks were taking to rafts in shark-filled waters to escape--was recently ranked second (just below Chile) in Latin American HDIs, and is usually ranked in fourth or fifth place. By using the recent PPP estimates for GDP, he noted Cuba would probably rank somewhere around 12th, mostly because of its claimed (and in his view, over estimated) life
expectancy and years of education. (One participant had noted that returns to education of Cuban immigrants had distinctly declined in recent years when measured against similar American workers.) He had little doubt that Cuban per capita GDP, which grew rapidly during the 1970s period of high Soviet subsidies but then fell astronomically, is either similar or below that of 1959. Nevertheless, he and others cautioned that per capita GDP is a very inexact measurement over long periods of time, given the changes in technology and consumption patterns.

Much of the reduced future expectations stemmed from policy analyses of both US and Cuban changes as well as the external environment. Besides the agricultural and "cuenta propista" (CP) reforms mentioned above, the Raul Castro Administration made some major changes in the early 2010s; it permitted relatively free foreign travel for all citizens, also allowing them access to heretofore reserved resort hotels. It also permitted the sale of some residential homes as well as the sale of cars. These were the signals that encouraged the Obama Administration to renew formal relations and relax some travel and communication restrictions, in the hope that some political laxity as well as further economic reforms would follow. This hope is now dashed. Everyone knows of the maladies that affected US Embassy staff in Havana, requiring the US to drastically reduce its personnel there; added to this are the new Trump actions, tightening travel restrictions, banning American tourist use of military-linked hotels and other institutions.

But it is recent economic policies as well as the external environment that may have a greater effect. Already mentioned was the partial reversal of some agricultural liberalization as well as its overall failure in increasing production and efficiency as well as the failure of the sugar rationalization. The allowance of private CPs (which grew from about 150,000 in 2010 to over 580,000 in 2017) has had far more success, as has the sale of cars and houses; both leading to a major increase in B&Bs. But in August 2017, the Government froze all CP licenses; no new ones have been issued since. Moreover, it began an investigation into how it could "improve" the CP industry, even requesting CP license holders for their views. Shortly before the new Constitutional clauses were published in July, the Government issued 129 pages in the official Gazette of new restrictions on CPs. Virtually all the requests of license holders were ignored; instead they were: restricted to one license per family, fewer activities eligible for licenses, harsher penalties for violations (including a two year ban from prior licensed activities) and far more regulatory harassment. Given these restrictions, the CPs at the ASCE conference were reluctant to expect any of the proposed changes to Cuba's constitution—which would provide legality to CPs and ownership of private property—would lead to an improvement in their lot. It seemed clear that in spite of the new constitutional clauses there would be little, if any, increase in the Cuban private sector. One participant, an ex-diplomat, reminded us that a prior detailed study of Cuban vs. Chinese economic views
had underlined the Cuban dislike of private entrepreneurial success, which creates affluence for some. He noted this creates constant frictions when the private sector succeeds, producing a cycle of tolerance granted because of need and then repression because of private success. Cuban leaders know the Chinese model well; they have rejected it.

There will likely be no move to unify the highly distortionary dual currency and exchange rate; while the US dollar reserves might have made such an action--and even possibly dolarization--possible a few years ago, the small reserve base now makes it more difficult. Moreover, this would bankrupt most state firms, lead to a relative depreciation of the tourist sector industry's earnings (run by the military), and possibly lead to major disruptions. Even a hint of unification, which might mean the confiscation of Cuban pesos, led to a panic tampered only by claims such would not be done. Moreover, if done, it would require a much stronger fiscal position than Cuba now has. While Raul is no longer President, he remains head of the Party, his son is in charge of state security and his ex-son-in-law heads the all-important military enterprises, and he has been a very, very cautious reformer. One participant noted that while Cuba's homicide rate is low for Latin America (no other crime statistics are published), it is about average for harsh authoritarian or totalitarian countries. He then showed the amazing increase in crime that accompanied reforming Soviet nations (their homicide rates almost tripled), underlined the ever-present thievery of government property, disobedience of many regulations, and cynical rejection of authority now present in Cuba and predicted any major economic/political liberalization would likely lead to a similar explosion in crime. And, he noted, the authorities were very well aware of such a likelihood. Finally, one participant noted the increasing global toleration--and even defense--of authoritarianism. The Western pressure to politically liberalize may seem lessened, at least to Cuban leaders. Given these constraints, it is easy to see why the new President, Diaz-Canel, will have a hard time implementing any major economic or political changes.

Then there are the nonpolicy constraints. Provision of almost free Venezuelan crude continues to decline along with the Venezuelan economy. This has led to a new plan to increase solar, wind, and LNG sources of energy. This seems a non-starter. The plan presumes a 40 percent increase in energy demand over the next twenty ears; this seems ludicrous. Moreover, to the extent that capital equipment (solar and wind) and imported energy must be paid for (LNG), there are no resources available. China seems uneager to replace Venezuela as a Sugar Daddy. Without subsidized energy, the Cuban consumer is unable to pay for commercially-generated electricity; and a devaluation would make such energy even more unaffordable. Far more useful, according to this expert on Cuban energy, would be efforts to save energy, but the higher consumer prices this would require are not in sight. Then there are the constant claims that hurricanes are the major reason why tourism and agriculture have declined. Global Warming experts claim the Caribbean will
likely continue to suffer from even more such storms. Some participants hoped the Catholic Church could provide a way for relaxed political restrictions, but the Church remains one of the weakest in the hemisphere. Finally, the Trump Administration's restrictions are having an effect--almost half Cuba's first class hotels are now off-limits for Americans), and President Trump may well be in power until at least January 2020. American tourism has been affected, as have hotels closely linked to the military holding company. A Democratic President in 2021, however, may have less incentive to relax the Trump restrictions unless encouraged by further Cuban reforms; something not given a high probability now.

Most important is the demographic time bomb confronting the island. The joy of the Revolution affected Cuba's bedrooms; there was a massive baby boom in the early 1960s, about 55 years ago. These Cubans will soon retire, and they will live, if less productively, for years longer. This boom soon turned into a bust, with liberal abortion, declining fertility, and continued emigration of younger Cubans. One participant, using a demographic model found the resulting graphs scary. The problem stems from an expectation that the number of working Cubans will begin to decline very soon; the base of the usual demographic pyramid is a skinny trunk. With no changes, he predicted a dependency ratio (aged 65 plus over those 15-64) in thirty years of almost 50 percent; one working Cuban supporting one old Cuban, a ratio rare to a poor country and predicted only for Japan and a few other developed countries. Given Cuba's abysmal low productivity, this is a formula for future penury. Another discussant pointed out how demographic predictions can change (e.g. the overpopulated globe feared in the 1970s) or be handled, referring to Japan's innovative technological changes and increased immigration policies. But Cuba is not Japan, and few people would immigrate to Cuba. If anything, the first analyst may have been too generous in expecting no change in recent levels of emigration (ie, after ending the "wet foot, dry foot" US policy that strongly favored Cuban immigrants) or birth rates; increasing relative poverty may increase the former and reduce even the low levels of the latter.

Then there is the decline in sympathy for Cuba, in the United States as well as Europe, among its prior supporters. The maladies affecting US diplomats, the departure of the iconic Castros, the many other greater threats confronting the West, and the growing realization of the failure of so many Revolutionary programs have affected its image abroad. One participant noted that The Cuban drama has become quite marginal. President Trump is attacked strongly in the US for many of his actions, but there seems little response to his Cuban restrictions. There is, thus, every reason to expect few political or economic changes in Cuba and little improvement of the external constraints it faces. And there are many reasons why continued decline is very probable.

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The Association for the Study of the Cuban Economy (ASCE) is a non-profit, non-political organization incorporated in the State of Maryland in 1990. With members from the US, Latin America and Europe, its mission is to promote research, publication, and scholarly discussions on the Cuban economy in its broadest sense, including on the social, economic, legal and environmental aspects of a transition to a free market economy and a democratic society in Cuba. ASCE is committed to a civil discussion of all points of view. Affiliated with the American Economic Association and the Allied Social Sciences Association of the United States, ASCE maintains professional contacts with economists inside Cuba—whether independent or associated with the Cuban government—who are interested in engaging in scholarly discussions and research. Member of ASCE receive the “ASCE Newsclippings” that reproduce articles about the Cuban economy and society that are published in various sources, including blogs published through the Internet in Cuba.