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Cuba: Urgent Economic Problems to be Addressed Now for the Post-Covid-19 Context

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The emergence and spread of the Covid-19 pandemic have plunged the world into mounting tragedy and shock. The loss of life, the fear and anxiety of the sick and quarantined was soon followed by the economic blow. A plunge in production and employment, decrease in supply (sometimes of essential goods) and the rapid transmission of the shock to demand, the rupture of global production chains, among others, have unexpectedly emerged as amplifications of a crisis that is reaching us all.

Data for 2020 reveal a global economic debacle. The United Nations has estimated an adjustment in the already modest growth of the expected global product and has even suggested a contraction of almost 1% or more, as restrictions on movement and economic activity continue to expand in certain nations.

The World Trade Organization (WTO) predicts a decrease in world commerce of goods with scenarios where it decreases from 13% to 32%, and projects a decrease in services due to travel and transportation limitations. The International Labor Organization (ILO) initial forecast of nearly 25 million unemployed, as a result of the epidemic, has been adjusted upwards in more recent publications. Meanwhile, reports from different non-governmental organizations suggest that 500 million people could fall into poverty.

The U.N Economic Commission for Latin America and the Caribbean (ECLAC) has adjusted downward growth predictions for the region to 1.8% because of the Coronavirus, and these could be further adjusted as the epidemic develops. As a result of the loss of income, the number of poor could increase by 35 million (for a total of 220 million) and the number of people in extreme poverty by 22.6 million (totaling 90 million), numbers that could rise as incomes deteriorate.

Beyond the short term, where things are obviously going badly, there is only uncertainty. When the International Monetary Fund (IMF) and the WTO talk about recovery of the Gross Domestic Product and trade in 2021, they recognize that it depends on the ability to contain the pandemic, the gradual lifting of restrictions on movement, economic stimulus policies and the existence of effective treatments or a vaccine that achieves immunization against the virus. Some of these conditions may themselves be in conflict.

Up to now, Covid-19 has disrespected borders and social classes. And it has mobilized huge resources towards the research and development of vaccines that guarantee immunity. Those will not be available immediately, but research reports and the initiation of human tests reveal pressure to speed up deadlines for producing results by many countries, including Cuba.

At some point the world will win the battle of the pandemic and march to recovery. Countries will enter that new stage and develop in different ways. The differences that we see today will remain, and probably become more acute. The advanced economies will launch a race for recovery based on their stock of resources, the incentives the market creates for companies and individuals, and economic policy will employ the fiscal, monetary, and commercial incentives as reactivation springs.

Many underdeveloped countries, particularly the poorest, will have a very difficult time and will emerge even more weakened after the crisis, with governments that have limited policy options and in a global context where there will be no spare resources to be channeled their way. We should expect that the recovery processes will be based on dynamics of reindustrialization, strengthening of the State, entrenchment of models with increasing incorporation of technology, automation and online presence. Also, we should expect that producers will try to shorten global value chains as much as possible, looking for local suppliers and larger inventory and prioritizing redundancy over efficiency.

Cuba will definitely feel the immediate and combined impact of the disease and the negative economic shock. These will be transmitted inward beginning with a diminution in the availability of foreign exchange (disappearance of the tourist market, difficulties in obtaining new credit because of defaults to country and commercial creditors, probable decrease in remittances, reduction of certain export items) making it impossible to sustain

the usual payments for imported goods (for consumption, particularly food and inputs vital to production processes).

We should expect an increasing paralysis of economic activity, a progressive deterioration of income in the population and the treasury. During the initial stages of recovery, we will see increases in informal economic arrangements and job insecurity, inflationary pressures on essential goods such as food, personal hygiene and cleaning products, among others.

From the beginning, the situation has been aggravated by the customary presence of the U.S. embargo of the island. This, the current administration has marked with its peculiar emblem by adopting higher levels of aggressiveness in an attempt to cut Cuba off from the channels of access to hard currency - travel, remittances, medical services, and fuel.

In any case, the presence of the embargo has always placed Cuban policy makers in a suboptimal situation: hardly any decision in the commercial, credit, investment fields could be the best one. However, the distortions of our economic model in the fields of property and management, disincentives created by the appropriation of wealth, and the rules and policies governing our markets, prevent the Cuban economy from reaching levels of efficiency and production as great as its potential.

The proof is the meager growth of close to 2% obtained during the last five years, the insufficient foreign direct investment (FDI) it has attracted, the unavoidable levels of imports, the depression in exports, the low productivity in the State sector, and the insufficient wages paid to 70% of active workers. Considering that the growth rate approved in the plan for 2020 was only 1%, recession is almost a reality.

Once the pandemic arrived in Cuba, the authorities developed a contingency plan that uses one of the greatest strengths for crisis management: a strong, centralized State, accustomed to the administration of scarce resources, and a health care system that is free of charge for all Cubans, and that is well-organized and staffed with capable professionals. Although infections have continued to grow and there have been spurts of local transmission, the disease has not taken off uncontrolled. The insular condition of the island and the closure of the borders, as well as increasing measures of social isolation, suggest that the Covid-19 could be eliminated, or at least the dreaded spikes in the contagion curve could be mitigated.

Right now, survival is the goal. But the authorities should bear in mind that as we return to normality - whenever that is possible - the Cuban people should not leave the small trenches of their homes only to find an economic and social context of increasing impoverishment. Shock is inevitable, but the policies that are developed now can make

the gradual period of return to normality more bearable and even make a contribution to the growth and development of the island.

The global and national return to normality depends on the elimination or control of the disease. In case temporarily favorable scenarios develop for Cuba, the presence of a favorable context that fosters food security, recovery of the productive fabric, capture of the first flow of travelers to the region, and the reinsertion into international markets, Cuba needs to place growth and development for the Cuban people not just on the agenda but in the realm of possibility. This demands haste in the design and implementation of essential palliative and stimulating measures.

In what areas can the Cuban authorities be taking action to mitigate the impacts of the crisis and overcome it? It is basically about generating revenues, growing quantitatively and qualitatively, and adopting a strategy that aims beyond mere survival.

Changes in the Components of the Economic Model

The boldest measures to be taken are probably at the level of the economic model or in the structural and short-term measures that end up modifying the character of some of the economic model's components. This requires deep restructuring, since the current content and interrelation of each one of the economic model's components does not lead to the growth dynamics the country needs.

In this sense, an expansion of the domestic private sector, which, since the beginning of 2010, has demonstrated growth capacity driven by engines other than privatization, and increasing from about 147,000 "self-employed" workers to more than 620,000 in a pre-Covid-19 stage, is a step forward. Also, the "experiments" of private operation of State assets, promoting public-private integration, could channel profit-maximizing actions towards the achievement of national objectives.

In the sphere of disincentives created by wealth appropriation, particularly wages, the migration and exodus of professionals from the State to the non-State sector signals that urgent measures are necessary that far exceed previous efforts at partial wage reforms or employ limited mechanisms. It will be necessary to identify sectors directly oriented towards export and import substitution and guarantee, at least to these, degrees of freedom and incentives that allow managers and workers to change the widespread pattern of neglect and disorder, in order to make companies efficient and profit-generating.

Designing and implementing policies will be increasingly challenging. It will be necessary to continue to have policies that guarantee the availability of basic resources, such as food and hygiene, to all Cubans. However, a growing non-State sector and expanding

freedoms for the State-operated enterprises necessarily implies the increased use of traditional instruments of economic policy from market contexts in order to induce the desired behaviors in all actors.

As a rule, it will be necessary for both the State and private spheres to break the existing monopoly and oligopoly arrangements and increasingly make way for the incorporation of new suppliers and the dynamics of competition.

Expansion of the Domestic Private Sector

The replacement of the list that today authorizes some 130 activities in the Cuban private sector with one that lists only those that are prohibited would be in line with the gradual continuity of the reforms begun in 2010. At that time, the mere authorization of a limited group of activities (which were in general qualitatively naive) and the permission to hire a workforce generated notable growth in the domestic private space.

This occurred in the absence of credit stimuli (initially, and then to a limited extent), disproportionate fiscal demands, absence of a regulatory framework for the creation of enterprises with foreign or Cuban public capital, without access to formal channels of foreign trade and to wholesale markets. The entrepreneurial spirit took advantage of assets, savings, inventiveness, and even managed to capture informal foreign capital inflows that have been estimated to equal 50% of the amount of remittances arriving in the country.

Given the paralysis of State productive activity and the growing demands to satisfy end users, the authorities can again reuse the springs of the private sector.

It does not cost much to publish adopted rules in the Official Gazette. And it is easier to identify the areas in which for some reason it is not desirable to have participation by the non-State sector - at least for now - than to try to develop a long list of activities permitted to the private sector. The domestic non-State sector does not need such a list, as evidenced by its growth in adverse conditions, its ability to generate well-paid employment and its constant inventiveness in characterizing its projects so as to fall within the narrowness of the current list of permitted activities.

What the private sector will need is smart regulation that foment competition, eliminates the discriminatory treatment it suffers as compared to the State sector and foreign investors, channels its actions to generate foreign exchange (through investments and trade), and enables it, together to the State sector, to satisfy demand and projects of national interest.

So far, while no radical changes are in sight, there are encouraging developments. In the current period of containment of the Covid-19 pandemic, State and private activities have been restricted using criteria focused on preserving public health and not based on particular forms of ownership. The private sector has been allowed temporarily to modify its operations to alleviate its fiscal burden when its activities were decreasing or becoming paralyzed.

At the same time, there has been an appeal for the continuation of certain pursuits, such as gastronomy – fundamentally in the preparation of take-away food - and transportation, hired by local administrative councils to provide various services.

Agricultural Production

We need to pay urgent attention to food production, where the non-State sector has shined as the most productive of most foodstuffs. Inputs and liquidity should be redirected towards those that have demonstrated success in producing.

We can target some of the production to reach the population through regulated mechanisms, while the rest of the production should be through efficient channels (regardless of the type of ownership or management) that guarantee arrival to the consumer at prices that stimulate the different stakeholders in the value chain. It is necessary for the Cuban State to continue to expend large resources to immediately guarantee the food of Cubans through imports, but the recovery of Cuban agriculture depends on breaking with any practice that has hampered its performance.

Currency Availability

Cuban official statistics do not disclose its International reserves but a comparison of estimates by foreign sources from 2016 with current ones suggest a significant decrease. For example, in the monthly country report for February 2020, the Economist Intelligence Unit estimated that Cuba's reserves were just over 12 billion in 2016. For 2020, the estimate is some 9 billion, and for 2021 about 8.1 billion. The commitments made during the debt renegotiation processes, the diminished exports and the very limited capacity to substitute imports without compromising production, basic consumption and growth, place the island in increasing tension.

Any effort that augments capturing foreign currency is peremptory, much more so as there is no access to multilateral mechanisms for tapping financial resources such as the International Monetary Fund, the World Bank, and others. So today there is only access to the limited resources available from instrumentalities of the United Nations, such as those granted to deal with the pandemic.

For the Cuban authorities, the time has come to adopt extraordinary incentives to generate FDI and to direct them to the never-ending list of priorities. It will be necessary to link material incentives paid to the civil servant who successfully negotiates and captures inflows.

We must eliminate Intermediary agencies tasked with identifying and hiring local workers, or at least adjust their leonine demands, which in practice increase labor costs (foreign investors pay the agency but need to also pay the workers directly to actually stimulate efficient production). The local private sector should be authorized to develop initiatives with foreign capital, most notably on a small scale, where the local contribution is not necessarily measured by the amount of capital contributed but by innovation and thus development of the Cuban knowledge base.

Other options on the table for the Cuban authorities is promoting the use of remittances in productive efforts, rather than to satisfy consumption, and dedicating a greater effort to mechanisms of swapping debt (which must be honored) for investor reinvestment.

Our priority must be to ensure the growth of efficient production, with the capacity to satisfy domestic demand and to export. And, despite all the obvious adversity, the availability of skilled labor, the appeal of first mover advantage in a budding market, the geographic location of Cuba with its Mariel Special Development Zone can serve as strengths, as the resizing of global production chains occurs.

Increase in Income from Exports of Goods and Services Related to Health

In the current world context, exports of various modalities of medical services, medical equipment and biotechnological and pharmaceutical products, have expanded significantly. Today, they represent notable sources of export earnings. According to official figures, exports of health-related services generated almost USD 6.4 billion in 2018, while biotech and pharmaceutical products revenues could be over USD 400 million.

Cuba's medical service exports are experiencing uncertainty as a result of the loss of markets, especially in Latin America (most notably in Brazil) and the coercion the current U.S. administration is placing on governments with which Cuba has trade agreements and even collaborates with in solidarity. However, the debacle that has led to the expansion of Covid-19 has enhanced the powerful image of Cuban medicine - in terms of the organization of its health system, the positive health indicators of the population, the country's willingness to engage in goodwill missions abroad, and the levels attained in a variety of markets. All of these create new opportunities for Cuba.

Emergency medical brigades have been recently deployed to some 20 nations, reinforcing the existing presence in 60 others. Some are provided the services without charge, but certain engagements, including by some nations recently added to the list (such as Andorra), will probably become new sources of income for Cuba. The demonstrable effect from these new medical missions has led to a diversification of the market, incorporating countries with high per capita incomes.

In the case of goods, Cuba also reports having received increasing requests for biotechnological products, including interferons produced nationally, which have shown promising results in some experimental treatments for Covid-19 patients.

To the foregoing, we can also add a future expansion of medical tourism. This will depend, however, on the adoption of a bold investment strategy by Cuba to position the island as a medical destination, as soon as international travel begins to recover. The current reality is that Cuba would continue to enjoy a competitive advantage in terms of price, unique treatments and attractive destinations.

Repowering the Tourism Sector in Moderation

Prior to the spread of the pandemic, a group of Cuban academics questioned the growing national investment effort in the tourist sector. The unease was motivated by the urgent need to bolster other sectors (such as industry and agriculture), the deterioration of part of the physical plant due to lack of maintenance, and the evident slack in employment levels in recent years. In 2019, 74,211 rooms dedicated to the tourist sector averaged an annual occupancy rate of 48.2%, one of the lowest in the history of modern tourism in Cuba. The North American market, which had been part of the motivation that led to the bet on tourism, contracted.

That previous debate seems to have now been settled by the developments. If formal or self-imposed travel restrictions are maintained throughout this year, the Latin American and Caribbean region will see a 25% contraction in tourism. Some reports predict recovery levels by the end of the year, but it is hard to predict if pre-crisis levels will be reached in 2021.

The Cuban authorities, for the foreseeable future, will have to negotiate with its counterparties regarding investments in progress. But, from now on, there must be a firm decision made to discontinue investing in new hotels.

The foregoing, by the way, does not imply that tourism has lost its capacity to generate income and productive chains in the future. Its geographic location, the existing facilities and a flexible private sector with extremely attractive rooms and outside attractions, may

favor Cuba in attracting the first flows of travelers to the region. To this end, local eradication of the disease and dissemination of statistics that show below-average Covid-19 infestation and mortality will be essential in distinguishing the island as a safe destination.

Local control of the epidemic could allow positioning that attracts travelers who “escape” from affected regions and would prefer to go to a safer destination with quality medical care in the event of an emergency. This may be possible even during the initial quarantine period, and for the medium or long term. We now have a market with the potential to combine traditional and medical tourism.

More than ever, Cuban authorities should consider the domestic private sector as an ally, make available the marketing channels now fundamentally reserved only for the State sector or for the joint ventures with foreign companies, and combine efforts in the generation of income. Expanding the activities permitted to the private sector is essential. Otherwise, informality will predominate, raising risks and decreasing income for all parties.

By Way of Closing

We do not want to end these observations without touching on some financial and monetary aspects. Apparently, for the moment, the much-discussed monetary unification has moved to another level of analysis by the authorities. Everything indicates that although the Cuban convertible peso will tend to disappear in the medium term, the existence of new stores accepting free convertible currency suggests that, whether or not acknowledged, we are perceiving a partial dollarization of the economy, even if that currency does not actually change hands in the actual transactions.

Even before we move on to adopting the new Business Law of 2022, it is necessary to clarify the role that Cuban small and medium-sized private companies should play in the future project. How is the Cuban light industry, a key national asset, going to obtain sufficient capital to operate in order to avoid unnecessary imports?

Should we set aside for now the State monopoly on foreign trade, as it operated in the past? Should monopolies be allowed to exist in certain economic activities, in the absence of healthy competition that produces benefits for all?

Once the epidemic is behind us, or the worst of it, we Cubans will have survived, hopefully mourning the least possible loss of life. The living and the healthy will then have to face the urgency of survival and uncertainty.

If we take the strengths of centralization and crisis management employed in the short term as a validation of past practices that have only dragged us into debt and stifled our growth and development, we will be condemned to a scenario of increased precariousness and will continue to mortgage our future as a nation.

It could be different. Surviving will be an arduous exercise, but more wholesome if that exceptional effort is made in a context where the options tend to grow and not to be limited. It will be a welcome change, a continuation of the logic of the reform of 2010, painting a vision with a future for the individual if it is structured correctly for the whole society.

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