

**Policy Forum on the Cuban Economy: Challenges and Options  
A Report**

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**Organized by:**

El Centro de Estudios de la Economía Cubana  
El Centro de Investigaciones de la Economía Internacional  
The Economics Department and The Norman Paterson School of  
International Affairs, Carleton University  
The North-South Institute

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### **Background**

The Cuban economy has experienced considerable macro-economic growth in recent years. The dynamism of sectors such as tourism, mining and the export of health services, and the reinvestment of revenues into infrastructure and other public goods, appear to be driving this growth. Yet in 2007 senior Cuban officials acknowledged that major “structural problems” endured. Their July 26, 2007 call for new ideas and measures<sup>1</sup> has intensified debates on economic and social policy options. Research centres in Cuba have been encouraged to feed evidence, insight and constructive proposals into these debates.

Canada has a stake in these debates by virtue of its significant investment, trade and development cooperation relations with Cuba. Drawing on its own experiences and on its involvement in international policy debates, Canada attempts to contribute modestly to the search, by Cubans, for solutions to their complex development challenges.

Against this backdrop, two Canadian and two Cuban research institutions combined their strengths to organize a two-day “Forum on the Cuban Economy: Challenges and Options”. The objectives of this meeting were to:

- Promote evidence-based policy debates on current economic development challenges and policy options in Cuba
- Begin a discussion between selected Cuban and Canadian social scientists on ways of feeding research into policy debates, and
- Lay the foundations for future Canadian-Cuban collaboration in this field.

Forty experts from Cuba, Canada, the USA and Jamaica, from academia as well as government, were invited to present research-in-progress and explore policy options together. The discussion was off-the-record, frank and constructive.

This report summarizes the essence of our discussions, without attribution. It follows the structure of the Forum, which began with an overview of the economy and moved to panels focusing on key sectors and challenges. In some instances we reordered the presentations to more clearly convey the coherence of our discussions. The report ends by outlining possible future collaboration in this domain.

### **The big picture**

There was broad agreement that the Cuban economy has enjoyed a gradual recovery since the deep recession in the early 1990s and more impressive growth since 2003, even though the extent of that growth varied according to whether Cuban measures of ‘social GDP’ or international norms were used.<sup>2</sup> But in per capita terms, consumption may still be below the level of 1989. GDP growth estimates for 2006 thus range from the official

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<sup>1</sup> See Granma, 27 July 2007, for the full speech by Vice-President Raul Castro.

<sup>2</sup> ‘Social GDP’ is used to capture the value of social goods and services produced in Cuba. Cuba is working with the UN Economic Commission for Latin America and the Caribbean (ECLAC/CEPAL) in an attempt to harmonize its GDP measures with international standards.

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rate of 12.5% to *The Economist's* estimate of 9.5%.<sup>3</sup> This growth has been driven by dynamic professional services exports to Venezuela and other countries, which have apparently overtaken tourism as a source of revenues. Venezuela, China and the Cuban government have also invested heavily in national infrastructure and in the oil sector.

Presenters agreed that growth should not mask challenges such as the crisis in agriculture, the declining investment in industry, low productivity and low salaries in the state sector, or the acute shortage of housing and transportation.<sup>4</sup> In his July 2007 speech, Vice-President Raul Castro called for new measures to address such structural problems.

Presenters offered a number of general policy options in this regard, ranging from:

- Expanding the scope of *perfeccionamiento empresarial* beyond the current 20-25% of public enterprises that are benefiting from the incentive-based modernization program
- Decentralizing economic decision-making to firms and local authorities
- Investing more in technology to raise productivity
- Providing more material incentives for workers to raise production
- Narrowing the exchange gap between the Cuban and convertible pesos, and
- Removing subsidies, ending rationing and liberalizing prices.

There was vigorous debate on the relative merits of these measures. Some participants stressed the importance of combining measures such as price liberalization, for example, with complementary policies such as raising salaries and establishing a broadly-based taxation system. Others suggested that Canada could help in this regard, building on its extensive cooperation with Cuba to establish a progressive income tax regime.

### **Agriculture**

The papers presented on this panel underscored the various challenges in agriculture. Research by Cuban institutions shows that the production of certain foodstuffs has increased in recent years (e.g. some vegetables, pork and eggs), but production of foodstuffs like maize and milk falls far short of domestic demand. Sugar production also continues to decline. Productivity remains low: agriculture now employs about 20% of the labour force while only contributing 5% to the GDP. Gaps between supply and demand have led to increased prices and a surge in imports to more than \$1 billion. This has created new opportunities for food exporters in Canada though there has also been renewed competition from US suppliers. For Cuba, imports have been essential to cover food rations and ensure rising per capita calorie intake in the short-term. But they also raise major questions about Cuba's longer-term capacity to meet its food security goals.

One presenter argued that Cuban agriculture could be turned around by further decentralizing economic decision-making, processing and distribution. Market incentives

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<sup>3</sup> Denis Séguin, "Viva la evolución," *Canadian Business*, Vol 80: No 4 (12 February 2007), p. 4.

<sup>4</sup> Other economic concerns include production capacity constraints in export-oriented sectors like nickel and sugar, and the fact that GDP growth has led to higher imports and an increased trade in goods deficit.

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could be used more widely to stimulate efficient production and distribution. Other options included bringing fallow lands back into production, reinvesting in the sugar supply chain to take advantage of interest in renewable energy, and attracting more foreign direct investment (FDI) into agriculture.

Yet some participants questioned whether continued investment in agriculture represented an optimal use of scarce resources. Others argued that not investing in the transformation of agriculture could have “traumatic” consequences for certain regions and population groups. All agreed that such trade-offs urgently required study.

### **Industry and the knowledge economy**

Two presentations on the manufacturing sector and industrial policy confirmed the secular decline of Cuban industry since the early 1990s. Noting that this was due to the combined effect of the US embargo and the collapse of the Soviet Union, one presenter suggested that deindustrialization could be turned around. Indeed, the establishment of a special relationship with Venezuela and the emergence of the ambitious *Alternativa Bolivariana para las Americas* (ALBA) cooperation process, may offer new market opportunities and economies of scale for a re-tooled Cuban manufacturing sector. For example, it might be possible to process and export agricultural foodstuffs to ALBA partners. Some participants questioned this argument, however, and the wisdom of investing scarce resources to renew Cuban manufacturing or build a capital goods industry, particularly given the dynamism of the new services sector.

Two presentations on knowledge-intensive industry and services confirmed the economic and technological dynamism of medical services exports, medical tourism and the pharmaceutical industry in Cuba. One researcher suggested that the domestic pharmaceutical industry supplied 85% of Cuba’s demand for medication and was becoming a major foreign income earner, with Cuba emerging as a leader in human vaccines. Considerable Canada-Cuba cooperation had developed in this field – in research & development, production and marketing. Another presenter documented the remarkable expansion of foreign patients travelling to Cuba to receive medical services (known as “Mode 2”) and Cuban healthcare providers travelling to other countries to provide their services (“Mode 4”).

These presentations prompted many questions about trade-offs with equity considerations. For instance there were concerns that health services exports had a high opportunity cost for Cuba’s aging society. One response was that this was not yet a major problem in Cuba because of its favourable doctor to patient ratios, and because \$25 million of the \$40 million earned per year from medical services exports and health tourism are reinvested into national healthcare, according to official sources. Another presenter went further, suggesting that notwithstanding concerns about equity, sustainability and technological dependency, Cuba should invest even more in this sector by training more health professionals and scientists, and by providing greater incentives to the domestic pharmaceutical industry. Some participants reiterated the call for much more systematic research into the economic and social trade-offs of investing in the

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revitalization of agriculture or industry, versus the temptation of shifting resources even more dramatically towards the tertiary sector, and notably the export of health services.

### **Social policy and demographic trends**

Cuba's enormous investments in public healthcare and education since 1960 are key factors that enabled its achievement of a level of human development. One presenter noted that the government had reinvested in these areas to broaden public access to social services, developed new social programs targeted at vulnerable groups such as seniors, and emphasized education for the knowledge economy. However, these programs needed to be underpinned by productivity increases in the wider economy. A complementary presentation showed how Cuba's increasingly top-heavy demographic structure -- due to increased life expectancy (77 years), declining birth rates and continued net emigration resulting in absolute population decline -- may jeopardize the fiscal basis of an already-stretched welfare state. According to one presenter: "Cuba is paying the price for its social successes."

Another presenter explained how pensions are an acute manifestation of this challenge. Pensions are falling far short of living costs, and there is a growing gap between contributions to, and payments by, state pension funds. Even with the trend towards salary increases in firms benefiting from *perfeccionamiento empresarial*, workers' contributions could not underpin forecasted increases in aggregate pension payments. The speaker estimated that there were 3.1 active workers for every pensioner in 2006, and that this would fall to 1.5:1 by 2020. In response there were several policy options:

- Raising the age of retirement from 55 (for women) and 57 (for men) to 60 and 65 over the next 20 years, or offering incentives for delayed retirement
- Integrating workers in private firms (large and small) and security forces personnel into a single public pension scheme
- Increasing workers' mandatory contributions to pensions funds, mainly by expanding the scope of the *perfeccionamiento empresarial* program well beyond the 20-25% of public enterprises benefiting from this program
- Maintaining the current fund while closing it to new entrants, establishing a new fund for new workers (based on contributions from them and from their employers) and wisely investing some of these assets to make them grow.

The presenter noted that this proposal required further elaboration and especially discussion among stakeholders in Cuba. The Cuban government could possibly use these ideas as inputs as it studies its options and consults citizens in this area of social policy.

### **Small and medium enterprises (SMEs)**

The main presenter on this panel began by sketching the evolution of Cuban policies towards small private enterprises. They contrasted this to the emergence of a dynamic information and communications technology sector in Ottawa, in which SMEs have

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played a major role. They also compared the relatively favourable Cuban tax regime governing joint ventures with foreign capital, to the restrictive tax regime for SMEs.

On that basis, the presenter argued that Cuba could do more to harness its peoples' entrepreneurial flair by facilitating legitimate activities in this sector, instead of restricting them. They sketched the contours of several policy alternatives in this respect:

- Relaxing licensing requirements to foster more competition
- Allowing professional self-employment -- while maintaining strong public goods
- Providing more legal access to inputs needed for legitimate businesses
- Simplifying the tax system while strengthening its equity provisions
- Reconsidering regulations like the "12 chairs" limit in private restaurants
- Establishing micro-credit facilities for SMEs, and
- Legalize specialization between producers and vendors, etc.

The presenter also suggested that cooperatives offered complementary mechanisms to foster local entrepreneurship and innovation.

In response, a Canadian participant agreed that while SMEs could be sources of employment, income and innovation. But for this person the key policy and research question was: "What are the conditions under which SMEs could generate net economic and social benefits?" Cuban participants also reminded us that their government seriously considered liberalizing restrictions on SMEs in the mid-1990s but backtracked when the US announced that it would support SMEs as way to hasten regime change. The strategic challenge for Cuba was how to capture the benefits of SMEs without leaving itself vulnerable to international intervention. How could research, and exchanges with other experts, help Cubans identify feasible policy options in this important but delicate area?

### **Foreign direct investment (FDI)**

Both presenters on this panel documented the significant increase of FDI in Cuba since the foreign investment law was passed in 1995, reaching some \$950 million in 2006 according to one estimate. They noted that this growth has been accompanied by changes such as disinvestment from the capital goods sector and the decline in the number of partnerships. Investment has also focussed on tourism, mining, energy, construction and some newer areas such as biotechnology and medical services. Canada has been active in this regard, and is now the third largest foreign investor in Cuba – particularly in mining.

The presenters agreed that FDI has brought fresh capital and technology into Cuba, and that it has facilitated access to new markets. They suggested that Cuba should attract FDI into sectors like sugar, particularly given rising prices for ethanol and other derivatives. Finally, they noted an apparent levelling off of FDI in recent years, though they had different explanations for that trend.

Drawing on experiences with FDI in the English-speaking Caribbean, one participant argued that the degree of benefits derived from foreign investment (like those from

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SMEs) depends on a number of firm-specific and contextual factors. Those factors include the negotiating strategy of the host government and/or host country firm, their ability to build sufficient benefits (employment, taxation, technology transfer, access to markets) into initial and subsequent contracts with foreign enterprises, and their ability to maximize benefits in practice. In order to ensure the transfer of “dynamic technologies” from joint ventures, host country governments and firms needed to develop synergies amongst themselves as well as with national research institutions. The latter could inform the authorities’ negotiating strategies and help them learn from their experiences.

Participants suggested that longitudinal case studies could help stakeholders learn from concrete FDI experiences. Comparative analysis, in Cuba and with experiences in other countries, could help build a broader understanding of policy options in this domain.

### **Globalization and local development**

In this session one presenter discussed ways in which core competencies determine how Cuba producers are integrated into world markets, and how they might move up the supply chain to improve their earnings. For instance, what was needed to upgrade products? Were there sectors such as tourism or specialised services on which the government might focus its support, which could then stimulate growth and innovation in the rest of the economy? Would the development of industrial clusters within Cuba, or as part of a regional strategy with ALBA at its core, improve longer-term growth and employment prospects? These were a number of areas that could benefit from further research, using value chain and industrial organization theories.

While Cuba has been able to ensure social services are accessible to citizens throughout the country, it continues to face challenges in the unequal spatial distribution of economic activity. As explained by another presenter, this reflects the variation in natural resource assets throughout the country, which had led to concentrations of economic activity such as mining and tourism. The government had attempted to offset this through various policies, including the establishment of sugar factories in major towns. But economic pressures since 1990 had led to the closure of several such factories, generating new types of disparity within the country and new pressures for internal migration.

In the discussion a number of participants raised questions about the prospects for Cuba in changing regional and global contexts. What could be done to respond to the devastating consequences of factory closures, particularly in the eastern part of the country? Could Cuba work with other countries to acquire the technology and bargaining power needed to move up the value chain? How could it encourage greater agricultural diversification, for instance into livestock and horticulture? How could it reinvest surpluses from activities like tourism, into social services or new productive ventures?

## Conclusions

The meeting was considered a success by participants, in raising key challenges facing the Cuban economy and in identifying research that could illuminate policy options. The presentations and discussions underlined that the Cuban economy had experienced a marked turnaround in recent years, with strong growth recorded especially since 2003. National and foreign investment had increased, in both the productive and social sectors, as had SME production -- generating improvements in employment and living conditions for many citizens. Cuba had attracted active interest in its economy from new allies such as China and Venezuela, as well as more traditional partners such as Canada and Spain. It had also expanded its presence in the regional market for professional services, health tourism and human vaccines, and there was considerable potential for expanding these knowledge-intensive activities as well as renewable energy.

Nonetheless these positive trends had been accompanied by enduring structural difficulties. These included: declining production of many food crops leading to a heavy dependence on imports; increasing imports more generally leading to a trade in goods deficit; declining investment in manufacturing notably in sugar processing; severe transportation shortages and bottlenecks; an aging population putting at risk the financial sustainability of social services notably pensions; and constraints on SME expansion.

Cuban, Canadian and other experts presented a range of policy options to address these challenges. The many proposals tabled over the two days included:

- Expanding the coverage of the *perfeccionamiento empresarial* program
- Further de-centralizing economic decision-making to firms and local authorities
- Increasing national investments in transportation infrastructure
- Relaxing the policy environment for small enterprise
- Collaborating with other Caribbean countries to negotiate FDI and develop regionally-based but world-class industries
- Relaxing controls on production and consumption and gradually liberalising prices, while raising import tariffs
- Reviewing pension financing and eligibility.

It was generally agreed that research was needed to identify the appropriate policy mix for meeting Cuban social and economic objectives. Much of the policy advice in the world today is derived from evidence gathered in other countries and especially by think-tanks concentrated in the North. Many people reiterated that a key research lesson is that context matters – one size does not fit all. Evidence from other countries about the impacts of price liberalisation or the contribution of SMEs, for instance, may not always be appropriate for the Cuban economy and its people, given their particular specificities.

This underscores the importance of further national research -- especially collaborative, multi-disciplinary research -- to understand current complexities and identify viable solutions. Experience suggests that knowledge-based policy-making requires ongoing engagement between policy makers, researchers and stakeholders, to ensure that research

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is relevant, timely and understood. Cuba has established a number of state commissions bringing together research centres and policy makers to grapple with various economic and social challenges. There may also be scope for those beyond the island, in the Caribbean and other countries including Canada, to support these Cuban processes.

### **Participants**

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