



The Political Economy of Change in Cuba

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“Cuba: A Services-Centered Survival and Development Plan”

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From tertiarization to sustainable development?

- TERTIARIZATION AND THE GOODS-SERVICES DYCHOTOMY (1-19)
- THE LAW OF VALUE IN A SOCIALIST ECONOMY (20-23)
- CUBA, CHINA AND VIETNAM: SIMILARITIES AND DIFFERENCES (24-33)
- A KNOWLEDGE-INTENSIVE SERVICES DEVELOPMENT PATH (34-38)

Tertiarization (1)

- This PPP illustrates the **dramatic shift of Cuba's economy towards services**
- (largely due to) the structural weakness of virtually all goods-producing sectors
- and **proposes some policy guidelines that might contribute to overcome the structural crisis of the island's state socialist model ***

*I will not mention the US embargo. This, of course, does not imply any underestimation of its crippling impact.

Tertiarization (2)

- **Increasing weight of the services macro-sector (SMS)**
 - decreasing weight of the goods macro-sector (**GMS**)
- **SMS composed by two sub-macro-sectors**
 - **Infrastructural and other goods production supporting services (IGPS)**, with relatively **strong linkages** with the **GMS**
 - **Directly needs-oriented services (NDS)**, with **very weak linkages** with the **GMS**

IGPS

- Rely for their functioning on the availability of a consistent amount of dedicated **physical capital**
- **Not directly** aimed at the **satisfaction of human needs**
 - rather ancillary to the production and transportation of goods
- output has substantially the nature of an **intermediate product** entering an enlarged macro-production function of goods
- backward and forward **linkages** are **strong**

The performance of **IGPS** tends to go hand in hand with that of the **GMS**

NDS

- **Directly aimed** at satisfying **basic** (health, education, social assistance and security) and **non-basic** (such as hotels, restaurant, and other **tourism-related** activities) **needs**

- **Labor intensive** and, in many cases, **skills and HK-intensive**
 - especially **education, health, and S&T**
 - Yet, also **tourism** has increasingly being attracting some of the **brightest and most entrepreneurial** young professionals and skilled workers

- **Not physical capital-intensive**
 - particularly **professional services** such as **health and education**
 - **knowledge –intensive**
 - **and direct human contact essential conditions** for service provision
 - comparatively **little need for any material support**

NDS are the most **de-linked** from the sphere of **material goods** production.

Cuba's GDP in 2000

➤ **Services were 3/4 of total GDP**

- **IGPS was the largest sub-sector**

- 43,5% of total GDP, almost 60% of services GDP

- **DNS was smaller**

- 30% of total GDP, 40% of services GDP

➤ **GMS was only 1/4 of total GDP**

- Non-sugar manufacturing 15.4%, sugar industry 2.2%, Agr and fishing 6.6%

2 structural trends unfold in the 2000s

➤ **The relative weight of services in GDP further increases**

- around **80% in 2005 -2009**
- GMS keeps shrinking
- about 19% in 2005-2009*
- manufacturing stays almost the same but agr falls to 3.9% and sugar collapses to 0.4%

➤ **DNS grows, pulled by booming Health**

- **By 2009, DNS 41% of GDP, 52% of SMS**
- **Health from 7.7% in 2000 to 15.8% in 2009****
- Culture and sports also double to 4.3%
- **IGPS falls along with GMS**
- By 2009 only 38.4% of GDP, 48% of SMS

* Cuban statistics report also « import tariffs», at about 1% of GDP

** The magnitude of the growth of the health sector is inflated by the new evaluation methodology adopted in the 2000s

The goods-services dichotomy (1)

- **GMS most integrated with the world economy**
 - Cuba's small size
 - pronounced import dependency
 - process of **value creation cannot be ultimately divorced** from the structure of **relative prices** prevailing in **international markets**
- notwithstanding the ubiquitous distortions in the domestic arena

The goods-services dichotomy (2)

- In other **services**, especially **DNSs**, the **price structure** along the whole value chain is **mainly determined by non-market factors**
 - **discretionary power** of Cuban **planning authorities**
 - largely – albeit not exclusively – **extra-economic motivations** which shape the **intergovernmental agreements with Venezuela** and the other countries who **buy the bulk of Cuba's professional services exports**

- The **new macroeconomic protagonism of professional services** was predicated on **an ad hoc price structure**
 - set up **originally mainly for social and political, rather than economic goals**

The goods-services dichotomy (3)

- One of the dimensions of the **lack of intersectoral integration** of Cuba's economy
- a very **high degree of segmentation** between the **goods-producing** and the **services macro-sectors**
- and thus of their respective price structures

The goods-services dichotomy (4)

Sectors exhibit diverging performance trends

➤ **DNSs grow fast**

- obtain more resources
- less dependent from the dysfunctional bulk of the domestic economy
- reported growth rates magnified by the application of the new GDP evaluation methodology

➤ **The GMS languishes as**

- is more dependent, linked with the bulk of the domestic economy

Professional Services (PS) exports

- Cuba's **external trade balance** is now **primarily dependent on services activities** (medical and other PS) which are among the **least integrated** with the rest of the economy
 - **divergences** in the **mechanisms of price formation** along the **value chain** and **inter-sectoral linkages**
 - central resources allocation priorities
- Yet, in practice, some services exports show ex post a significant degree of **international competitiveness**

An only apparent paradox

In fact, a **necessary consequence** of the **skewed and poorly integrated structure** of Cuba's economy

- **Internally integrated GMS in shambles**, cannot possibly be internationally competitive.
 - lack of investment
 - systematic non-respect of the law of value

- Conversely, scarce resources have been **allocated for decades** on a **non-market basis to prioritized social services**
 - blessed by a **relative isolation** from the rest of the economy, as
 - **intensive in HK, but not in physical K**
 - **not very dependent** on the **supply of inputs** from the GMS

The **most potentially tradable** components of these **intrinsically social services - health and other PS -** eventually **achieved international competitiveness**

Exports of PS: pluses

- Allowed to **release** almost overnight the crucial **external constraint** which **structurally limits** Cuba's economic development
- So far, shifted towards exports part of the **supply potential created by huge past and present human capital investments**, which would have been largely underutilized otherwise
- Made possible to **achieve some GDP growth** in spite of the **negative contribution of domestic economic policies**
 - at least until the banking crisis, which led to the present economic downturn

The **strongest positive factor** in an otherwise grim picture that **prevents the economy from nose-diving**

Exports of PS: minuses (1)

Exports of PS in their present form probably **already peaked**

- **Doctors and other professionals are not micro-conductors, cellular phones or Ipods**
- **require many years of highly specialized training**
- **their productivity can hardly improve**

This is a clear, specific example of a **general economic principle**

- **Productivity can improve** markedly in the domains where people apply **ever-increasing knowledge to manipulate and transform nature**, thereby creating more and more goods of ever-increasing quality
- In the area of **specialized human capital formation such rapid productivity gains cannot be achieved**
 - due to the very **nature of learning**
 - and to the **heavy dependence of teaching from reciprocal human interaction**, which is itself very human capital-intensive

Exports of PS: minuses (2)

PS have **few forward economy and backward linkages** with goods producing sectors and also with other services sectors, and their **multiplier effect** is correspondently limited

- Due to the **specific characteristics** of PS and the **structural de-integration** of Cuba's economy, the **specialist knowledge** embodied in PS human capital has been **transmitted to the GMS only to a very limited extent**
 - positive exceptions there are the **pioneering advances** in the areas of **biotechnology** and in few niches in the **pharmaceutical and medical equipment** industry
- This limitation does **not allow Cuba** to reap the **potential benefits**
 - virtuous **intra- and inter-sectoral spillovers**
 - the ultimate **conversion of knowledge** into industry-wide **technical progress**
 - **enhanced systemic productivity** and **innovativeness** also in the **sphere of the material production of goods**

Exports of PS:sustainable?

- Present PS export boom cannot be the basis for further, sustainable development
- unless accompanied by a series of **complementary “industrial” policies** aimed at further transforming, enriching and diversifying this and other services sectors

Overcoming the infantile disease

- A **structural reform of the very state socialism model** should not be indefinitely postponed
- **Radical departures from the traditional state socialism model are required**
- The **guiding theoretical principle**, should be the **rational and realistic recognition** of the need for any present-day **economy** - to respect the **“law of value”**
 - with respect both to domestic and external equilibria
 - a fortiori in a **small, peripheral, and underdeveloped socialist economy**

The “law of value” in a socialist economy

Notwithstanding their profound differences

- Both socialism and capitalism are **socio-economic formations** belonging to a **mode of production** based on the **production and exchange of commodities** (and **services**)
 - both in socialism and in capitalism the production and exchange of commodities take place in the **productive*** sphere of the economy
 - generating a **surplus** that can be partly** earmarked to the **free or subsidized provision of social services** according to **non-market criteria**.
- Thus, in **both socio-economic formations** the **relative prices** of different types of products must **broadly reflect the underlying structure of production costs**

* Adapting to modern socialist and capitalist economies a Marxian concept originally elaborated exclusively to analyze the capitalist mode of production, the term "productive" refers precisely to the part of the economy that produces a surplus.

** Part of the surplus must be invested

*** Or goods.

2 key lessons from one century of socialist economic history (1)

- The socialist principle of **distribution according to work** must prevail
- abandoning
 - any residual of **irrational egalitarianism**
 - **unrealistic attempts** to implement **communist relations** of production and exchange on the backdrop of a severely **underdeveloped productive basis**

2 key lessons from one century of socialist economic history (2)

➤ **The State's planning capabilities are limited**

- In order to achieve development outcomes **superior** to those stemming from the **spontaneous** and anarchic interplay of **market forces**
- They should be **parsimoniously focused** on a **pragmatic and selective** form of **strategic planning**

As time passes by, it is more and more urgent

- To rationalize the presently **over-extended sphere of non-market production and distribution** of both goods and services
- This task cannot be accomplished without a **dramatic expansion of the scope and role of markets** and of **monetary-commercial relations**
 - and therefore of relative price and incentive structures

In turn, any meaningful market-oriented reform could not possibly work without

- overcoming the **double currency mess**
- restore the **meaningfulness of two key prices** in particular
 - **foreign exchange rate**
 - **real wage**

Cuba, China, and Vietnam: similarities (1)

Some of the structural market-oriented changes in Cuba will necessarily have to resemble those implemented in China and Vietnam

- **Market- and price-based regulation** shall substitute central planning as the **main guiding principle of resources allocation in the short/medium term**
 - the role of planning must correspondently become less ubiquitous and ambitious
 - evolving into a **market-compatible**, largely price-based array of policy tools
- The **main focus of planning** is to **steer strategically the overall process of development** as smoothly as possible, in a **long-run perspective**

Cuba, China, and Vietnam: similarities (2)

Grasp the big, enliven the small

- The Cuban State should limit its **more direct forms of intervention** in the productive* sphere to a **few strategic sectors (incl large-scale tourism)**
- These sectors are the **only ones** where the State should **retain full or controlling ownership rights**
- **Individual and small-scale activities**** shall be **liberalized** and allowed to function autonomously, in an essentially **market-regulated framework** dominated by **monetary-commercial relations**

* In the non-productive sphere, the state can maintain its presence

** In the primary, secondary, and tertiary sectors, including agriculture, fishing, manufacturing, trading, tourism, and other traditional services activities

Cuba, China, and Vietnam: differences (1)

History, geography and path-dependency matter, and the same blueprint cannot be applied mechanically everywhere

- The international scenario is different from the one which prevailed in the last quarter of the XXth century
 - the financial and economic malaise affecting the major capitalist countries
 - the very ascent of China and of the other so-called BRICs
 - the new correlation of forces in Latin America
- present both challenges and opportunities for Cuba's international trade and cooperation relations.

Cuba, China, and Vietnam: differences (2)

- **Many crucial structural differences**
between present-day Cuba, on one hand, and China and Vietnam
in the late 1970s- early 1980s, on the other hand
- **Size**
- **Wages**
- **Respective roles of services and
manufacturing**

Size

➤ **China, Vietnam are large**

- (potential) internal market, economies of scale,..

Even under the state socialist model

✓ before market-oriented reforms

- already advanced enough in the path of **quasi-autarchic, self-centered industrialization and economic diversification** to be able to produce (inefficiently) a vast array of industrial products
- according to a **relatively consistent self-centred price system**

➤ **Cuba is small**

USSR-funded industrialization largely failed due to (inter alia)
wrong **sectoral priorities, little diversification**

- inconsistent, distorted **price structure**
- **Small size**

Human Development (HD) and wages

Most Cubans are affected by deep poverty in terms of lack of access to virtually any consumption good or service beyond the realm of a very austere definition of subsistence

Yet, Cuba's HD is higher than that of China and Vietnam

- ✓ A fortiori, it is **incomparably higher** than the level of human development of the two Asian countries at the **time of the inception of market-oriented reforms**.
- Cuba's relatively **high level HD is crucially predicated on the sustainability of its public services**. Due to
 - the very **nature** of these services sectors
 - Cuba's specific **comparative advantage** built after decades of extraordinary **needs-focused policy priorities** in the allocation of scarce national resources
 - the **cost** of delivering rather good health, education, and other basic services in Cuba is relatively **low**

Nevertheless, it's **not a free lunch**

- The **cost of labor** in Cuba must **embody** the onus of **funding basic public services**, and therefore it is **too high to make the island an attractive location to set up labor-intensive, low-tech manufactures**
 - Applies to domestic and foreign investors, public-owned (controlled) enterprises and private firms.

Services and manufacturing

China, Vietnam

- most population were and are still **rural**
- rapid shift from agriculture to industry, **manufacturing**
- **little** weight of **services**

Cuba

- most population **urban**
- manufacturing **small, shrinking**
- extraordinary and increasing weight of **services**

Export-led massive industrialization?

Cannot be an option for Cuba

- in most manufacturing sectors, Cuba's endowment of **both physical** and (to a lesser extent) human **capital** would be **too scarce** to allow for **potential competitiveness** in international markets
- Cuba's **share of manufacturing in GDP** or in **employment** will **never approach** the levels of China and Vietnam

2 areas of manufacturing potential (i)

A **large area of low- and medium-tech essential sectors**

- among them **agro-industry** and **basic non-tradable manufactures**
- mostly supplied by domestic producers in virtually all semi-industrialized countries

➤ In Cuba, exceptionally **under-developed**, and hence **import-dependent**

In a medium term scenario Cuba might

- achieve **minimum acceptable efficiency and productivity improvements**
- sufficient to make it **viable a limited form of import-substituting re-industrialization**

2 areas of manufacturing potential (ii)

A small niche of **knowledge-intensive** sub-sectors

- **high, specialized human capital intensity**
- **low physical capital intensity**

Cuba already successfully produces biotechnology, drugs, and medical equipment*

- can **expand and enhance** its ability to **manufacture and export** these and other *knowledge-intensive goods*
- maintain and **selectively strengthen the traditional priority** accorded to these sectors in the allocation of public investment
- **reform elite public enterprises** to endow them with more **autonomy and market-orientation****
- promote various forms of **international cooperation** (such as FDI, joint ventures, and intergovernmental international agreements)
-
- * In 2009 medicines and pharmaceutical products export grew strongly and their share of total goods exports rose to 20% from 9% in 2008.
- **Elite Cuban service and manufacturing SOEs operating in health-related sub-sectors already enjoy a higher level of autonomy than most other enterprises.

A knowledge-intensive services development path

➤ **The Health cluster** and possibly other knowledge-intensive services
✓ i.e. some specialized R&D and consulting services niches

might hold a true **potential** for becoming the **engine** for a **sustainable development drive** for the Cuban economy as a whole

- most of the remaining **growth potential** in **agriculture and industry** is of an **import-substituting** nature
- **manufacturing ancillary and complementary**

* The health cluster includes a **goods-producing component** manufacturing vaccines, drugs, biotechnology products and medical equipment, as well as **diverse health-related services** such as **health tourism** and public health planning consultancies

The role of the State is crucial

in the **development of knowledge-intensive services***

- Cuba's **comparative advantage** can only be maintained and **enhanced** if an adequate amount of **public resources continues to be earmarked** to these sectors

* As opposed to non-strategic sectors

Necessary conditions...

- Enterprise **autonomy**
- **Incentives**
- **Flexibilize** monopolistic and vertical forms of control on specific services value chains
- Managed **competition**
- **New forms** of creative **entrepreneurship**
 - ✓ including **FDI** and **public-private partnerships**

...will not be sufficient unless

**The planning mechanism is
modernized and fine-tuned**

- utilizing both **price- and non price-based policy tools**

A key strategic objective

Exploit the potential **synergies and economies of scale** and **scope** that can arise from the **joint pursue** of **two** different and valuable **goals**

- Direct, **non-market** satisfaction of **basic needs**
- Generation of **foreign exchange** through the production of **tradable services**

An **intrinsic tension** between these two goals is inevitable

- **risk of over-penalizing basic service** functions
- **transforming health** and related sectors in a **purely money-making** machine

Yet, alternatives are few and the challenge is worth taking