Cuba: Macroeconomic Imbalances and the Sequence of Reforms

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Given the current magnitude of Cuba's macroeconomic imbalances, it is crucial to establish a clear sequence and set priorities for the country's reforms. Five years ago, the focus might have been on issues like economic efficiency, productivity, the dual monetary system, sanctions, and the slow, inadequate pace of structural and institutional reforms. Today, however, in addition to these unresolved problems, Cuba faces the largest macroeconomic imbalances since the collapse of the USSR in the 1990s. This year, the fiscal deficit is expected to exceed 18%, while the country has experienced four consecutive years of triple-digit inflation and is defaulting on renegotiated external debt.

So, where do we begin? What should be the first step? It is clear that all problems cannot be solved simultaneously. Given the limited institutional capacity to manage and guide the necessary reforms, it is essential to define priorities and establish a logical timeline to initiate the country's transformation.

The first principle is that not all problems, or even the majority, need to be solved in order to stabilize and rebalance the economy. It is not necessary to implement every pending reform to reduce the fiscal deficit, inflation, and the informal exchange rate.

Take the example of 1994 and 1995, when prices, the fiscal deficit, and the money supply were stabilized, and the decline in GDP was reversed. Even then, few would claim that most of the economic challenges or daily shortages for Cubans had been resolved.

The most orthodox view of reform suggests focusing first on the demand side, prioritizing monetary and fiscal stability. Conversely, an alternative approach would prioritize reforms in the productive sector, arguing that no fiscal or monetary measures will be effective unless goods and services are being produced.

Perhaps it is time to find a middle ground, simultaneously addressing demand adjustments while incentivizing production. This could be achieved if policymakers focus on issues that affect both inflation and fiscal imbalances, while also enhancing productivity and economic growth.

While there is no definitive answer for the optimal sequence of reforms and austerity measures, I propose that the restructuring of state-owned enterprises (SOEs) should be the top priority.

A large proportion of Cuba's SOEs are not financially viable. These entities continue to operate by paying extremely low wages, receiving state subsidies, functioning with soft financial constraints, and relying on an overvalued official exchange rate.

Restructuring insolvent SOEs would yield multiple benefits for both the demand and supply sides:

1. It would reduce subsidies, fiscal spending, the fiscal deficit, and the monetization of the deficit – currently the main driver of excessive money supply, triple-digit inflation, and the depreciation of the informal exchange rate.
2. It would enable the central bank to devalue and unify the official exchange rate, correcting relative prices in the economy—a crucial step toward adjusting the fiscal deficit on the revenue side of the budget.
3. It would increase average productivity in the economy, which, in turn, would help boost average wages.
4. It would demonstrate to foreign creditors and investors a serious commitment to deep and lasting reform, essential for renegotiating external debt and restoring credibility.

However, this path is not favored by some Cuban government officials, as it would require a significant expansion of the private sector to prevent a surge in unemployment. Achieving the goals outlined in points 1 to 4 would necessitate closing, merging, or downsizing unprofitable SOEs while creating opportunities for job growth in the private sector. The current framework for SMEs in Cuba is insufficient for these purposes and would need to be expanded.