

Chapter 2

Accounting for the Growth of Real GDP in Cuba, 1990–2010: An Exploratory Empirical Study

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ABSTRACT

This chapter examines the evolution of real Gross Domestic Product (GDP) in Cuba over the past two decades using a neo-classical, supply-side approach. On the basis of a Cobb-Douglas production function, it seeks to account for the contributions of capital and labor to output. It then considers the effects of the terms of trade and of the inefficiencies introduced by price controls. It discusses the difficulty in explaining the depth of the economic contraction experienced in the early 1990s and suggests that two factors played a temporary but important role: the interruption in the supply of equipment and parts from the Soviet Union and the impact of the huge monetary overhang that resulted from the interaction of large-scale monetary financing of fiscal deficits and price controls. The chapter then attempts to adjust for the overstatement by official statistics of real GDP in the first decade of the 21st century by focusing on the public health and social assistance sectors of the economy. The last section examines two sources of overstatement of effective employment in the data and their implications for labor market policy and output growth.

A BRIEF HISTORY

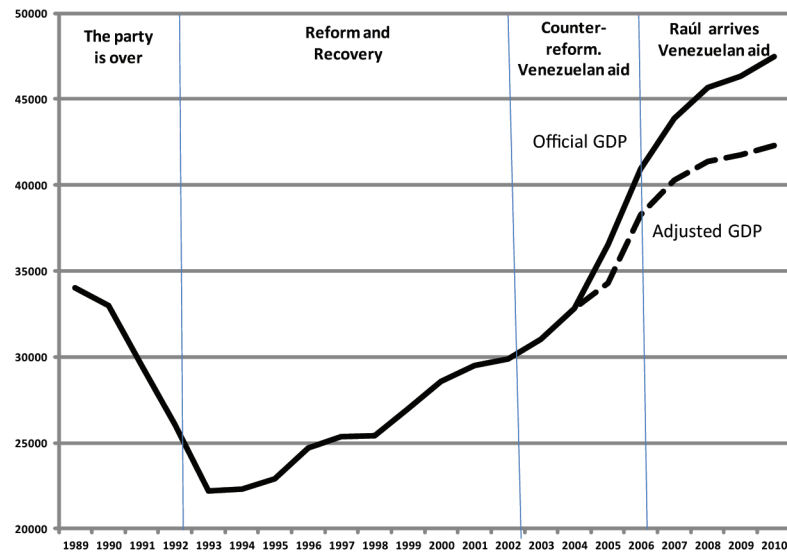
The solid line in Figure 1 illustrates the evolution of real GDP over the last decade of the 20th century and the first decade of the 21st century. The sample is divided into four specific sub-periods characterized by major differences in the external and/or the domestic policy environment.

- The first period (1989-1993) covers the years following the sudden drop, and then

the elimination of external assistance provided to Cuba by the former Soviet Union and the formerly communist countries of Eastern Europe. The period also features attempts by the Cuban government to address the contraction of economic activity by providing large-scale budgetary subsidies to state enterprises and financing the resulting fiscal deficits by monetary expansion, and by controlling most prices rigidly. The result was a huge monetary over-

DOI: 10.4018/978-1-4666-4745-9.ch002

Figure 1. Cuba: Real GDP (In millions of 1977 prices)



hang and forced saving on households. The peso was pegged to the U.S. dollar in the official market, but it depreciated sharply in the black market.

- The second period (1994 to 2002) features a major shift in economic policy and a relatively strong recovery from the post-Soviet recession. Subsidies to state enterprises were slashed, the budget deficit was sharply reduced, and monetary overhang was eliminated over the next few years. Macroeconomic stabilization was accompanied by several structural measures, including: the authorization of certain private and cooperative activities in agriculture and small-scale services; the de-criminalization of the U.S. dollar (which fostered a large increase in remittances from Cubans leaving abroad); and the relaxation of price controls in certain sectors. The peso continued to be fixed in the official market, but it floated in the informal and black markets where it regained most of the value it had lost in the previous period.
- The behavior of output in the third period (2002 to 2007) is perhaps the most puzzling. According to official statistics, the economy expanded at an unprecedented pace, even after it surpassed its new peak in 2005. Many of the reforms adopted in the mid-1990s were reversed: the dollar was re-criminalized; the restrictions on state enterprises were tightened; and the private sector was hindered by cumbersome regulations and unduly high taxation. Simultaneously, there was a large increase in economic assistance from Venezuela and a highly expansionary fiscal policy. Economic slack was rapidly absorbed during the period, although probably less rapidly than suggested by the official data because of the overstatement of real GDP.
- In the final period (2008-2010), General Raúl Castro became President of Cuba and secured the reins of the economy. After a brief but acute balance of payments crisis in 2008, the administration shifted to a restrained fiscal policy and the economy slowed down from its unsustainable pace

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