Cuban Integrated Financing Framework (CIFFRA)

Policy Note No. 10
Innovative Financing Agenda

United Nations
ECLAC
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Ministerio del Comercio Exterior y la Inversión Extranjera
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Innovative financing agenda

In December 2021, ECLAC published the 12th special report on the evolution and impact of the COVID-19 pandemic in the region. The report, entitled *An Innovative Financing for Development Agenda for the Recovery of Latin America and the Caribbean",*[1] sproposes five policy actions for development financing in the subcontinent: (i) expand and redistribute liquidity from developed to developing countries; (ii) enhance the response capacity of regional, subregional and national financial institutions; (iii) carry out an institutional reform of the multilateral debt architecture; (iv) provide innovative financing instruments; and (v) integrate these measures into a strategy aimed at building a better future.

One of the deliverables of the Joint Program "Support for the Development of an Integrated National Financing Framework for SDGs in Cuba" (CIFFRA), was a report that discusses the five actions proposed by ECLAC, and on that basis policy analyses and recommendations for Cuba were drawn up. In a first analysis Cuba's uniqueness in accessing sources of financing, due to the U.S. government's sanctions system, was highlighted. The fact that Cuba is not a member of the main International Financial Institutions (IFIs)[2] limits its participation in initiatives such as the reallocation of Special Drawing Rights[3] or the Debt Service Suspension Initiative (DSSI).

A second analysis warned of changes in financing flows to the region: (i) multilateral financing has lagged behind regional and subregional development banks (see figure 1); (ii) regional and subregional banks have focused their financing on strengthening governments, while national banks have focused their financing on the productive sector; and (iii) guarantee systems have become an important instrument for supporting MSMEs.

1 Economic Commission for Latin America and the Caribbean (ECLAC), *Una agenda innovadora de financiamiento para el desarrollo para la recuperación de América Latina y el Caribe*, 2021 [online] https://repositorio.cepal.org/handle/11362/47489.

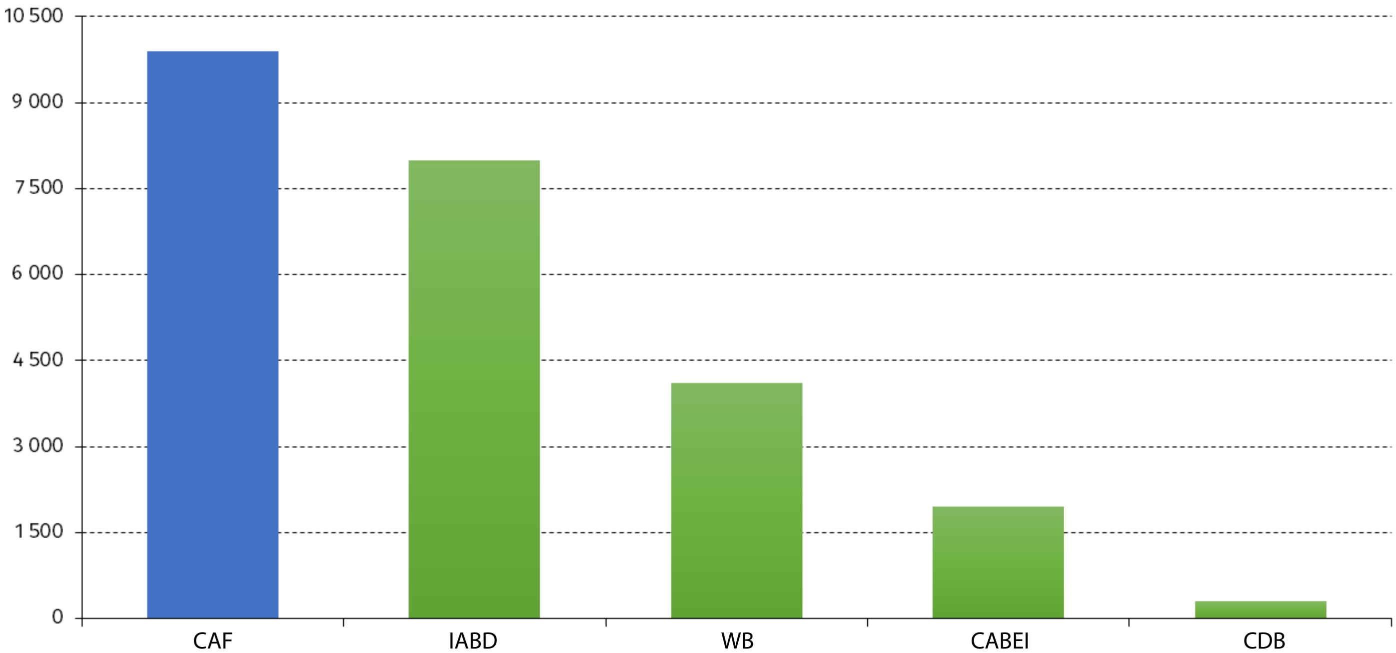
2 Cuba does not belong to the IMF, the World Bank or the Inter-American Development Bank. The Helms-Burton Act typifies the U.S. government's desire that Cuba not belong to these institutions (Helms-Burton, 1996): https://instituciones.sld.cu/facultadfinlayalbarran/files/2019/06/Ley-Helms-Burton.pdf.

3 Countries in the region with similar characteristics to Cuba received between US$300 million and US$700 million as part of the new SDR allocation in 2021.

Figure 1

Latin America and the Caribbean: development bank financing, January 2020 to February 2021

(Billions of dollars)



Source: Author.

The gradual loss of prominence in the financing of the region by institutions to which Cuba has limited access due to U.S. sanctions, such as the World Bank (WB) and the Inter-American Development Bank (IADB), and the need to resort to other regional and subregional development banks, is noteworthy. In 2016, Cuba signed a cooperation agreement with CAF. In April 2017, Cuba officially joined the Central American Bank for Economic Integration (CABEI), which recently approved the first financing to Cuba in support of counter COVID-19[4] efforts.

It is not known whether there have been attempts to approach the Caribbean Development Bank (CDB), which has lesser relevance in terms of financing volumes to the region, but has other identity, economic and political ties.[5] The need to identify opportunities for access to the Asian Investment and Infrastructure Bank (AIIB) and the New BRICS Development Bank (NDB)[6] also stands out, taking into account Cuba's participation in the New Silk Road initiative,[7] as well as its acceptance in 2020 as an Observer State of the Eurasian Economic Union.[8]

The role of national development banks in the PNDES financing strategy deserves particular consideration. Although there are no nominally established development banks in Cuba, in practice commercial banks combine commercial and development banking roles. This raises the question of whether it is necessary to create a development bank (which has been a demand of several sectors, especially for agriculture[9]) or

[4] EFE, "BCIE concede a Cuba crédito para producir 200 millones de vacunas anticovid", 2021a [online] https://www.swissinfo.ch/spa/coronavirus-cuba_bcie-concede-a-cuba-cr%C3%A9dito-para-producir-200millones-de-vacunas-anticovid/47253642.

[5] Although Cuba is a member of the Alba Bank, between 2009 and 2018 Cuba had received 16% of the Bank's financing, worth just US$72.8 million.

[6] Cuba belongs to the International Investment Bank (IIB), from which it received financing of 55.8 million euros in 2019.

[7] EFE, "China y Cuba concretan alianzas dentro de la Nueva Ruta de la Seda", 2021b [online] https://elnuevodiario.com.do/china-y-cuba-concretan-alianzas-dentro-de-la-nueva-ruta-de-la-seda/.

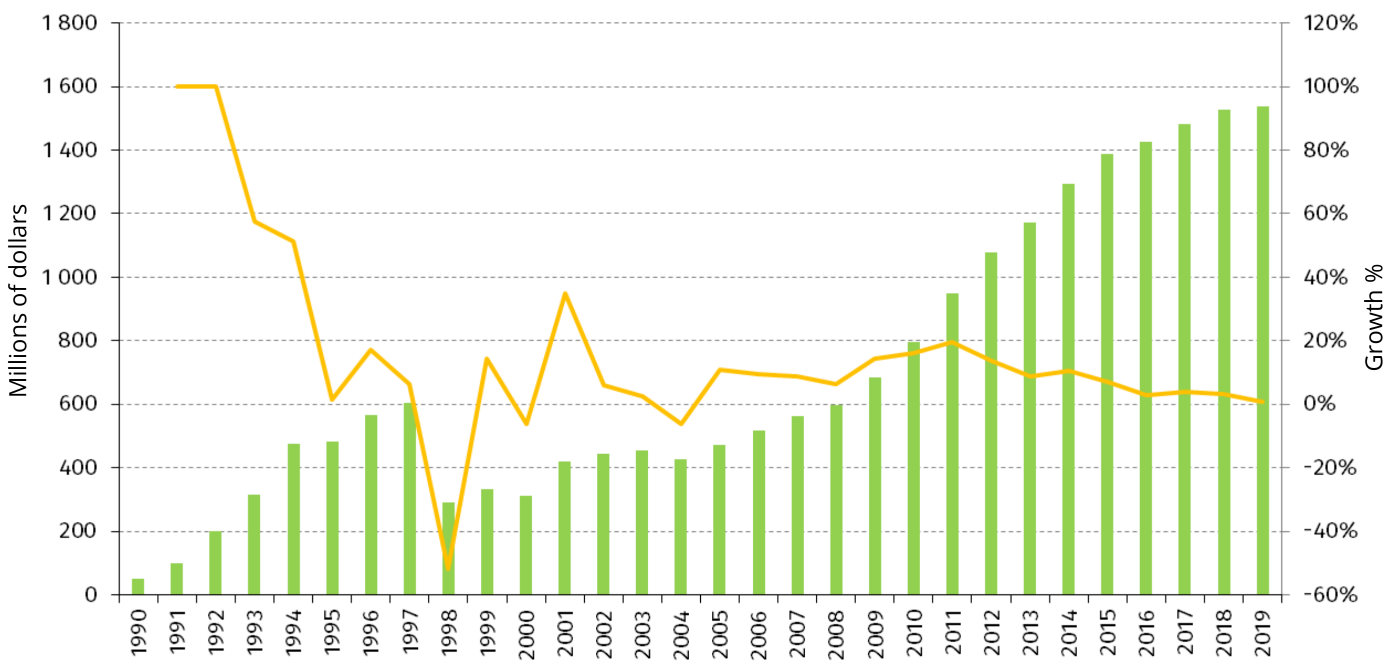
[8] Integration project between the Russian Federation, Armenia, Belarus, Kazakhstan and Kyrgyzstan.

[9] In 2021, the Banco de Fomento Agrícola and the Financiera de Microcréditos S.A. (microcredit financial institution for new economic actors) were created. However, neither can be considered a development bank. The Banco de Fomento Agrícola will operate from an existing commercial bank (BANDEC).

whether, on the contrary, what is required is to clearly specify the mechanisms for financing development within the public banking system.

A third analysis is linked to challenges in the design of tax policy, market regulation, the credibility of the financial system and the inconvertibility of the Cuban peso, which incentivize the use of cash as a means of payment and/or the carrying out of payment, exchange and financing transactions through alternative channels to the official ones. According to various estimates[10], about 46% of cash remittances sent by the Cuban-American community go through informal networks (see figure 2). Although these trends are significantly influenced by U.S. sanctions, particularly those related to remittances and other cross-border payments, it is necessary to continue developing strategies and public instruments to achieve greater and more effective formalization of these flows.

Figure 2
Cuba: informal remittance inflows, 1990-2019



Source: M. Carmona, “Mercado informal de divisas en Cuba”, bachelor in economics’ degree paper, University of Havana, Cuba, 2020.

Finally, ECLAC’s proposals highlight the role of innovative financing mechanisms. Given the characteristics of the Cuban economy and its vulnerability to the occurrence of extreme weather events (hurricanes, droughts), the use of Force Majeure clauses could be especially useful in the redesign of debt negotiation and management mechanisms. They also highlight the existence of underexplored opportunities in terms of access to green financing, given the greater international availability of these instruments and Cuba’s world-renowned efforts to address climate change and for environmental protection.

[10] M. Carmona, “Mercado informal de divisas en Cuba”, bachelor in economics’ degree paper, University of Havana, Cuba, 2020.

As evidenced in several CIFFRA exercises, the renegotiation of the foreign debt cannot be postponed. However, in the current national and international economic and political context, it becomes difficult to reach favorable debt renegotiation schemes with the Paris Club, as achieved back in 2015. Therefore, the use of innovative mechanisms is not only necessary for new financing, but also for the restructuring of the accumulated debt. The use of bonds linked to Gross National Income (GNI)[11] could be useful in this regard.

A look at new mechanisms and instruments for debt issuance and management requires building consensus on issues that are yet to be further addressed. On the one hand, it is necessary to deepen the debate on a gradual opening of the capital account, as an incentive to attract external financial flows in a context of limited opportunities for attracting foreign capital. This would not imply the elimination of exchange and capital controls, but rather a relaxation towards more indirect controls and traditional capital controls.[12] On the other hand, it is necessary to study alternatives for accessing capital markets, at least in small proportions or for specific projects, as a mechanism to diversify the sources of foreign financing.

In light of this report, five key messages could be incorporated into the diagnostics made by various CIFFRA exercises:

(i) Despite the important financing restrictions associated with Cuba's non-membership of the main IFIs, a shift is taking place towards a greater role for regional, subregional and national banks in development financing. Cuba has niches of opportunity in at least five options for rapprochement and/or strengthening relations with regional and subregional institutions that can be explored: (i) the Development Bank of Latin America (CAF); (ii) the Central American Bank for Economic Integration (CABEI); (iii) the Caribbean Development Bank (CDB); (iv) the Asian Investment and Infrastructure Bank (AIIB); and (v) the New Development Bank of the BRICS (NDB).

(ii) Despite having a large public bank distributed throughout the country, the levels of financial intermediation in Cuba are very low, separation between commercial and development banking activities of banks is fragile, and there are still restrictions on the financing demand in Cuban pesos. This means that one of the main sources of development financing in the region, national development banks, are not being tapped into. Therefore, a review of the role, actors and instruments for domestic development bank financing is crucial.

(iii) Mechanisms that allow for greater channeling of remittances and other cross-border flows through official channels should be further explored, as well as strategies that have a direct impact thereon (macroeconomic stabilization, recovery of the convertibility of the Cuban peso, design of tax policy, market regulation, and credibility of the financial system, among others).

(iv) International experience shows a wide range of innovative development financing mechanisms. However, these mechanisms require broad technical knowledge, institutional maturity and conducive macroeconomic environments for their implementation. Three areas in which their use in Cuba could be explored have been identified: (i) foreign debt restructuring; (ii) green financing (taking advantage of its greater availability and Cuba's environmental track record); and (iii) access to capital markets through leading sectors of the economy (such as biopharmaceuticals) and the support of multilateral organizations.

[11] Bonds linked to GDP or gross national income (GNI) are financial instruments that link the payment of principal or interest (or both) to the growth of GDP or GNI.

[12] Increasing use by natural persons of cryptocurrencies in deregulated schemes is imposing a de facto opening of the capital account, although still limited.

(v) Exploration of these opportunities for development financing requires institutions (organizations, game rules, instruments) attuned to a very dynamic field, that demands flexibility and specialized knowledge. In this regard, building consensus on key issues that have an impact on all these areas is imperative: (i) capital account management conditions, constraints and demands (exchange and capital control methods); (ii) flexibility and decentralization of financing management decisions; (iii) assimilating negotiation perspectives that take into account risks taken on by creditors; and (iv) the need to create specialized technical teams for the design, implementation, negotiation and monitoring of development financing instruments.

CIFFRA Technical Committee
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ECLAC

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