Cuban Integrated Financing Framework (CIFFRA)

Report N° 1
Development Banking Challenges in Cuba

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In previous exercises of the Joint Program "Support for the development of an Integrated National Framework for Financing the SDGs in Cuba" (CIFFRA), attention was drawn to the growing importance of development banking in Latin America and the Caribbean in promoting economic recovery and productive transformation. Consequently, proposal was made to open the debate on the relevance of promoting development finance institutions in the country.

Accordingly, and as part of CIFFRA deliverables, a panel entitled "Challenges and Opportunities for Development Banking in Cuba" was held on June 3, 2022, with the participation of more than 30 representatives of the government, academia and the United Nations system, many of whom have participated in previous exercises and discussion sessions of the project.

Presentations by Francisco Villarreal (ECLAC official), Karina Cruz (researcher at the Cuban Economy Study Center) and Ileana Estévez (advisor to the vice-president of Banco Central de Cuba) discussed in depth references, challenges, opportunities and recent experience of development banking in the country.

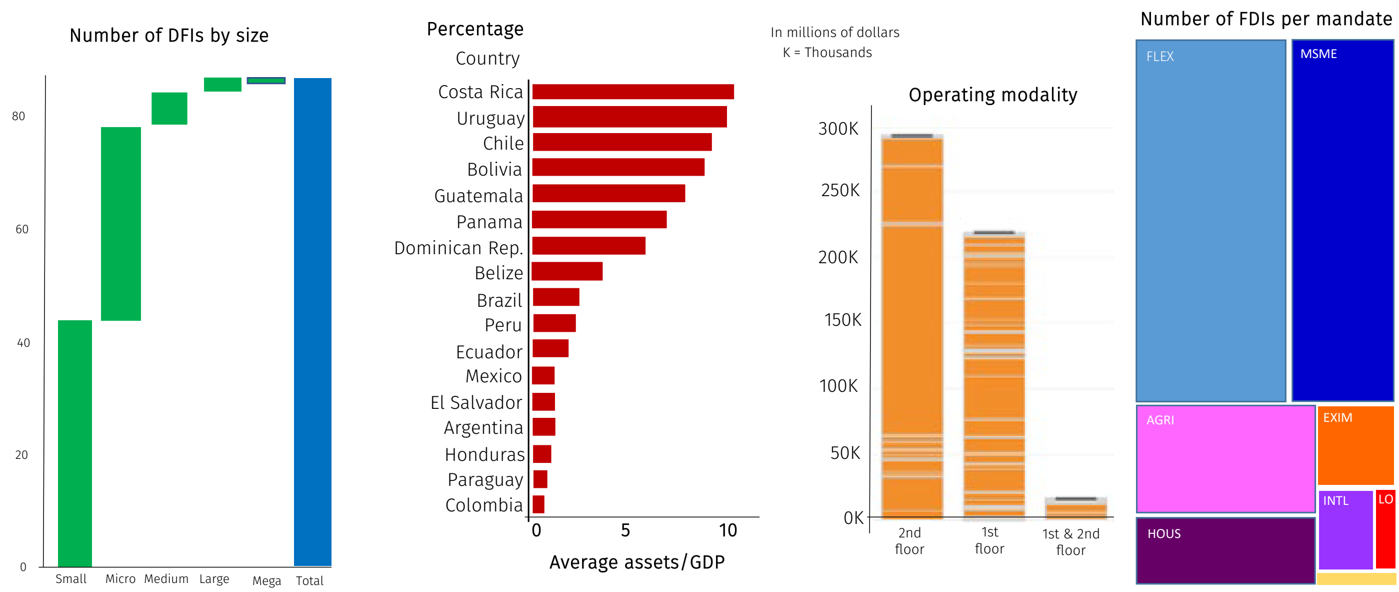
Francisco Villarreal reviewed the experience, functions, evolution and challenges of Development Finance Institutions (DFIs) in the region and the world. He pointed out that, as a result of the 2008 international financial crisis, a new consensus emerged that questioned the efficiency of financial markets and promoted a regulatory turnabout. In this context, there was a renewed interest in DFIs, valuing their countercyclical role (as demonstrated during the pandemic) and their capacity to facilitate financing for initiatives that due to their characteristics, do not attract the interest of private investors (infrastructure, new technologies, and financial inclusion).

According to the Finance in Common initiative, there are currently more than 500 DFIs around the world, with an asset volume of nearly 23 trillion US dollars. It is estimated that together, they provide around 2.2 trillion US dollars in financing annually, approximately 10% of global public and private investment each year.

Figure 1 shows some characteristics of DFIs in the particular case of Latin America. Almost 80% are classified as small (the heterogeneity of the region is also evident in its DFIs). However, many of these institutions are small in absolute terms, but relatively large in their specific markets. Most operate through second-tier institutions and they have different mandates ranging from institutions with a multiple mandate (FLEX) or to support MSMEs, to those that are more focused on rural support or foreign trade financing.

He pointed out that, while DFIs play essential roles, there are still challenges that cannot be solved but can be mitigated. On the one hand, there is a natural mismatch between a financing supply that seeks a commercial return and the risk and return characteristics of the segments on which DFIs tend to focus. This mismatch is what creates dependence on public support. On the other hand, reconciling the long-term development function of DFIs with its countercyclical (short-term) function would entail a series of compromises, but it is still unclear how they are going to be resolved.

Figure 1
Characteristics of DFIs in Latin America and the Caribbean



Source: F. Villarreal, 2022.

The biggest challenge lies in strengthening the risk management capacity of DFIs, given the nature of their activities and the fact that: (i) they serve segments that private financial institutions are not willing to serve, and (ii) they assume risks that private financial institutions are not willing to assume.

Based on 10 criteria, Karina Cruz discussed the main features that distinguish commercial banking from development banking, and then identified which are, on average, present in Cuban banks; all this as a background for a reflection on the need to develop DFIs in Cuba given the challenges of financing productive transformation.

The comparison of these 10 criteria shows that Cuban banks, despite defining themselves as commercial banks, explicitly or implicitly share traits of development banking. In terms of funding sources, credit term and services provided, they operate as commercial banks. In terms of credit subjects, risk management and profitability criteria, they operate as development banks. From the point of view of ownership, mandate, rates, and the requirements and guarantees demanded, they share characteristics of both commercial and development banks.

This mix of functions and characteristics leads to overlapping and conflicting roles, as well as to distortions and uncertainties in terms of performance measurement and accountability mechanisms. In practice, it leads to banks being unable to function properly either as commercial or development banks.

Based on the foregoing, she asked a series of questions that would help elucidate whether there is a need or not for a development bank in Cuba: are there reasons that justify the existence of a development bank in Cuba? Are there underserved sectors or segments from the point of view of financing? Are the problems of some of these sectors of a financing or different nature? Can development banking solve them? Is the existing bank structure or scheme sufficient, or is it necessary to separate the functions of development banking and commercial banking? What conditions would have to be changed for development banking to work?

Ileana Estévez presented the specific and recent experience of agricultural development banking in the country. After commenting on its background, she pointed out the objectives that motivated the promotion of an agricultural development bank, namely: (i) correct the dispersion of financing sources for this sector; (ii) increase the specialization of feasibility studies for investment projects; (iii) develop regulations and incentives to facilitate specific financing for agricultural production, and (iv) enhance the effectiveness of mobilizing resources for these purposes.

To this end, a proposal was put forward to create a specialized structure in an institution of the banking system to serve the agricultural sector and the sugar industry, under development banking conditions and based on the following premises: (i) obtain cost-free resources that would allow to invest them at very low interest rates; (ii) contribute to reducing budgetary resources to meet imbalances in the agricultural activity; (iii) to allocate funds, mainly from the State budget, to provide financing to the productive base under more favorable conditions; (iv) concentrate financial resources, including those coming from abroad, to support agribusiness; and (v) offer bank financing to production units under the modalities of credit lines, loans, bill discounting, factoring or leasing.

Given the importance of coordination actions, an Agricultural Coordination Committee was created to organize the financial processes in accordance with the productive capacities and conditions at any given time[1].

The first funds were provided in September 2021. Figure 2 shows the producers benefited disaggregated by crop (more than 1,900), with rice producers standing out as they have received around 27% of the financing granted. It should be noted that during the short period of this experience, there has been a positive impact on producers, who have shown interest in benefitting from it.

The panel concluded with a wide-ranging discussion by the participants, highlighting the following messages:

i) the foregoing elements support the need to promote DFIs in Cuba (beyond the specific experience of the agricultural development fund) to attract resources and for their investment and specialization;

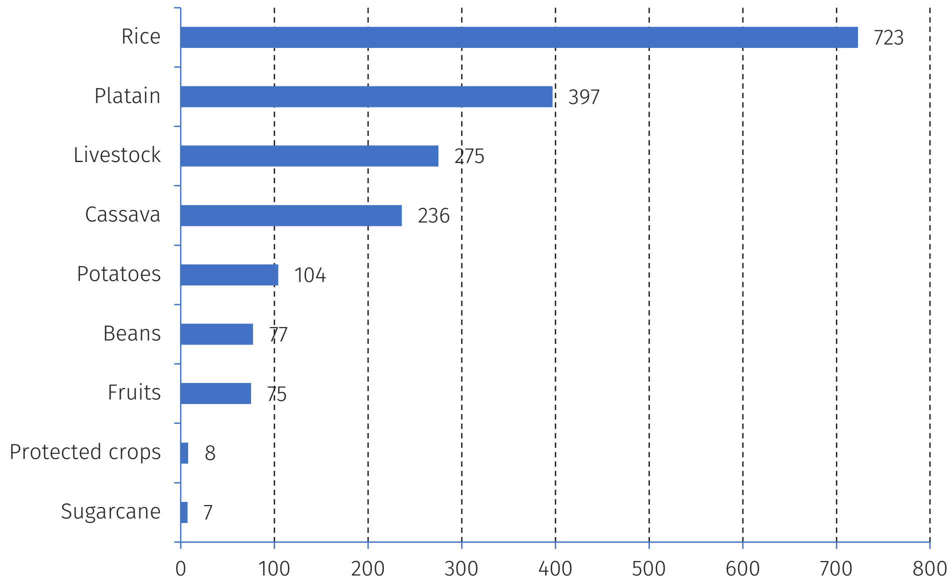
ii) the problems of the agricultural sector are not only financial but of a structural nature as well, hence this is a necessary condition; but it won't suffice to overcome the challenges of productive transformation;

iii) in schemes of this nature, the bank must be sufficiently specialized and autonomous to be able to carry out the most rigorous risk assessment possible;

[1] The Committee is chaired by the Ministry of Economy and Planning and is integrated by the Ministry of Finance and Prices, the Central Bank of Cuba, the Ministry of Agriculture, the state sugar business group (AZCUBA), and the participation of the Bank of Credit and Commerce (BANDEC), the National Insurance Company and the National Association of Small Farmers, as permanent guests.

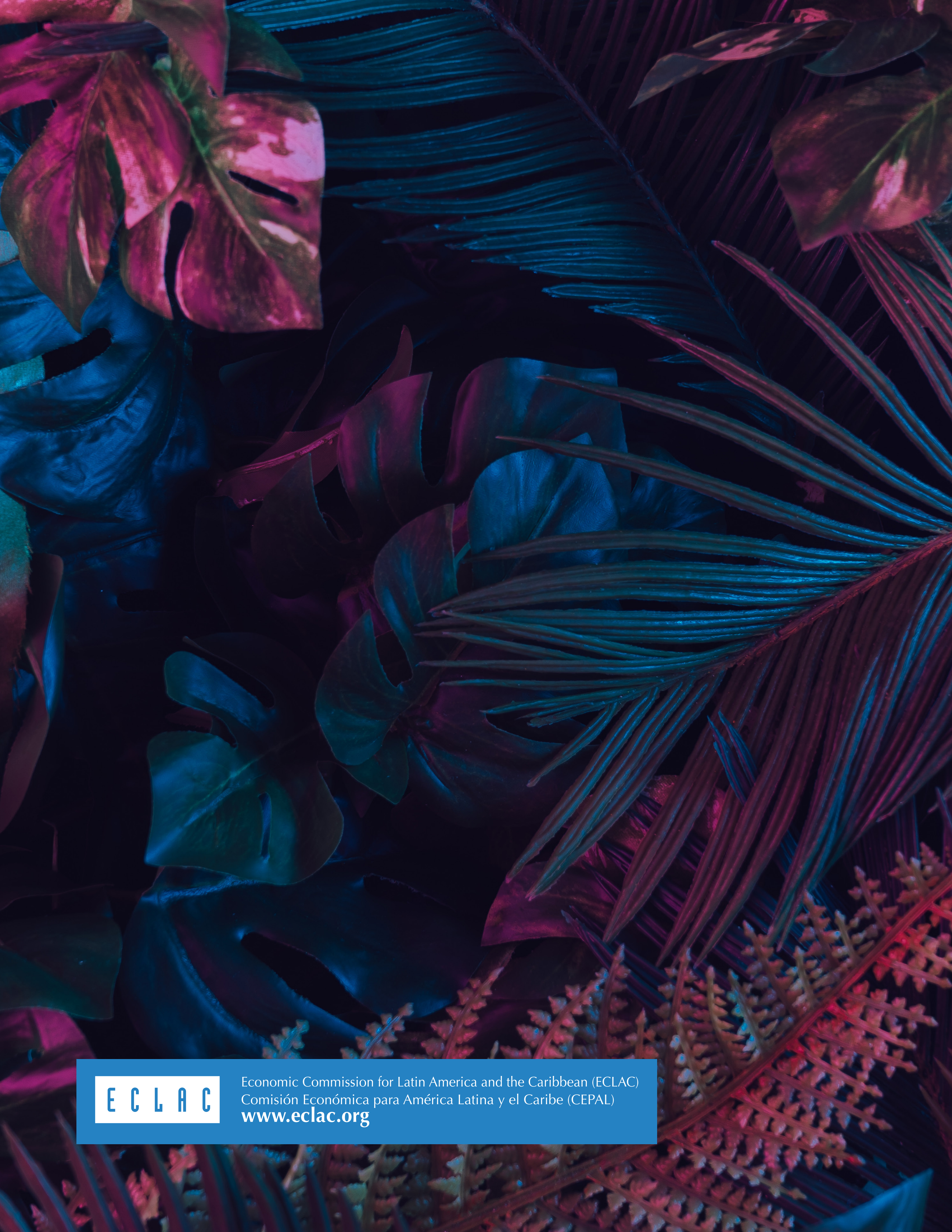
iv) the issue of funding this type of institutions is very important, taking into account the current problems of allocation of resources for unwarranted uses.

Figure 2
Cuba: benefitted producers, September, 2021 to May, 2022



Source: Estévez, 2022.

CIFFRA Technical Committee – July 28, 2022



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