

# Economic and Political Impacts of the Extraction of Oil in the Exclusive Economic Zone of Cuba

Effie A. Acevedo Guasp, Rebeca J. Agosto Rosa, Martha N. Concepción Pantoja, Aziria Rodríguez Arce, Ana G. Serrano Ocasio, Prof. Alicia Rodríguez Castro  
School of Social Sciences

## Background

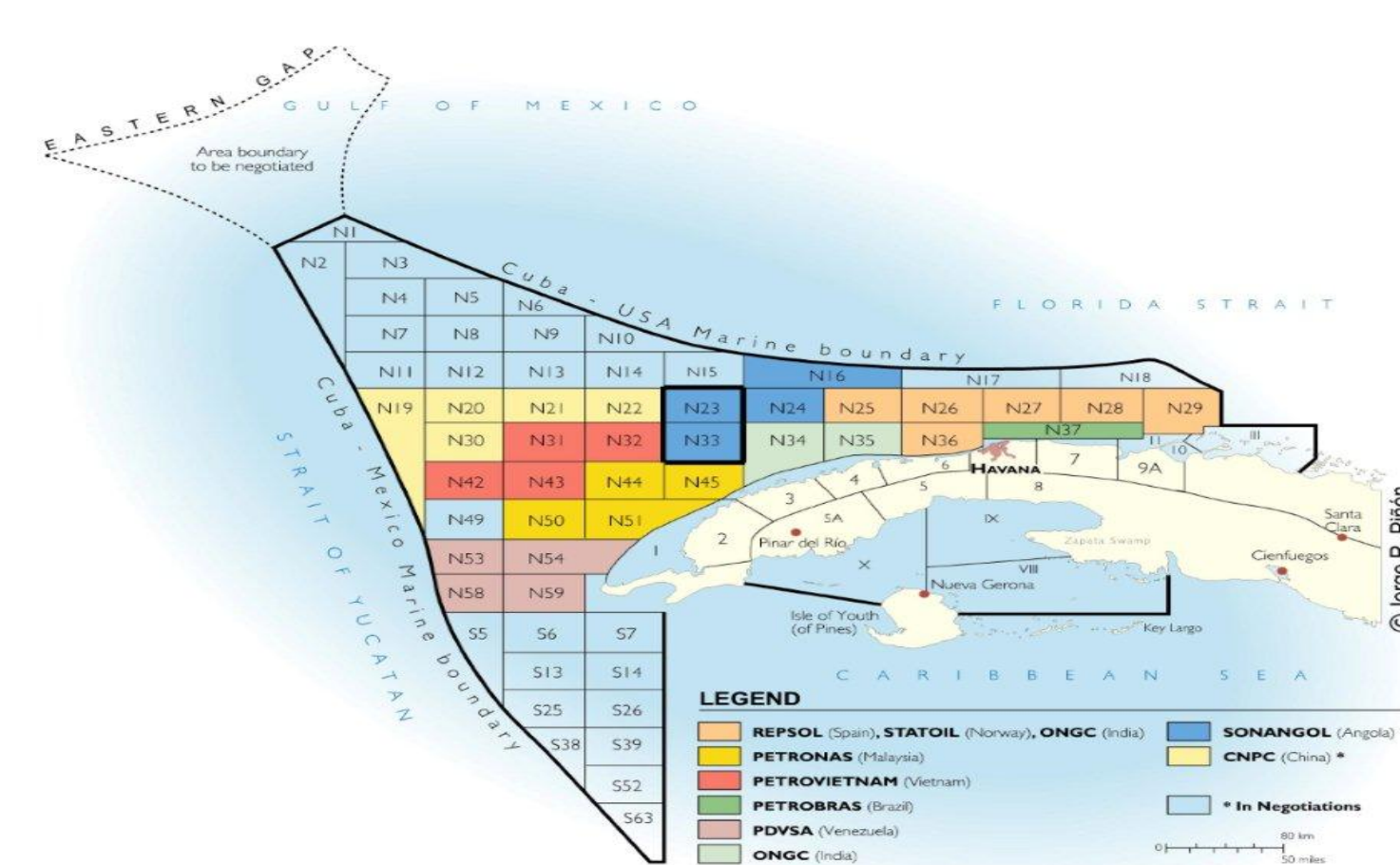
In 2004, the Spanish oil company Repsol announced the discovery of high quality oil deposits in the Exclusive Economic Zone of Cuba (EEZ). The U.S.G.S. estimates the oil reserves at 4.6 million barrels, while the Cuban government estimates them at 20 million barrels. With the extraction of oil, Cuba may be able to reduce its dependency on oil imports and even become an important oil exporting nation. The EEZ has been divided into 59 blocks, 22 of which have been given to international oil companies through Production Cooperation Agreements (PCA) in which the companies agree to engage in certain exploration costs in exchange for 50% of the production rights.

## Summary

This study explored Cuba’s risk of experimenting the Oil Curse. This theory states that oil-related revenues impact the political and economic system of a nation. The consequences are the rentier, repression, and modernization effects. Thirteen variables of Cuba’s political and economic institutions were examined. A tendency to fall into the Oil Curse was identified; specifically, manifesting the rentier and modernization effects. Further investigation should expand the analysis to quantitative analysis and related research should continue the analysis of the effective impact that the development of the oil industry might have had on Cuba and its institutions.

## Objectives

- To evaluate the characteristics of the political and economic systems of Cuba.
- To foresee the allocation, by the Cuban government, of the potential revenues from the oil extraction of the EEZ.
- To determine whether the propensity to fall into the *oil curse* exists.



## Theoretical Framework

The Oil Curse Theory states that the political and economic institutions before the oil extraction, determine how the oil-related revenues impact the political outcome and future economic conditions of the nation (Schubert, 2006). The consequences of the oil curse are described by Ross (2001) in three main effects: rentier effect, repression effect, and modernization effect. The conditions of the Cuban institutions today, will influence the effects the emerging oil industry will have on the nation.

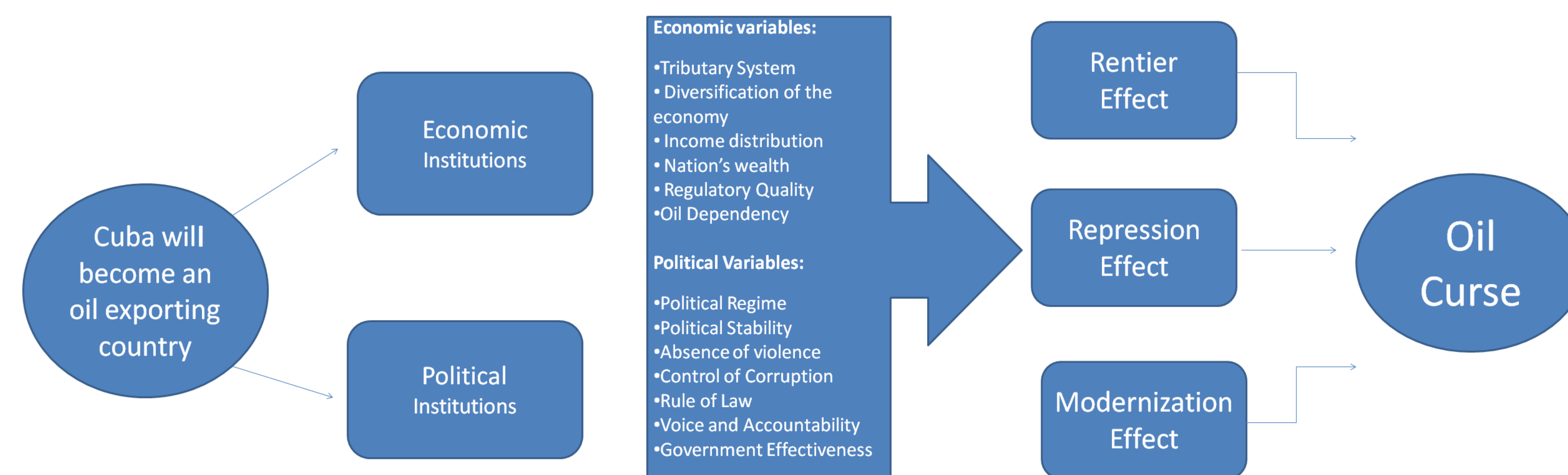
Effect	Definition
<b>Rentier Effect</b>	Government use of income obtained from oil exploitation to guarantee permanent power.
<b>Repression Effect</b>	Government use of income obtained from oil exploitation to increase the military and repressive forces.
<b>Modernization Effect</b>	Government management of income obtained from oil exploitation prevents social and cultural transformations. It also prevents economic development and modernization.

## Method and Procedure

To examine the political and economic institutions of Cuba, thirteen characteristics were chosen: political regime, oil dependency, diversification of the economy, income distribution, nation’s wealth, tributary system, government effectiveness, control of corruption, regulatory quality, rule of law, voice and accountability, political stability and absence of violence, and level of education. Each of these characteristics were described, analyzed and later linked with the corresponding effect of the *oil curse* in order to predict a possible future scenario for the institutions of Cuba as an oil-exporting country.

## Findings

Variables	Description	Oil Curse Effects
<b>Tributary System</b>	Tax collections as a percentage of overall state revenues has decreased over time. Still, they continue to represent 60% of the government’s total net revenues.	<b>Rentier Effect</b>  The widespread corruption and poor government effectiveness would make it more likely for the <i>rentier</i> effect to occur. It would facilitate the government’s use of oil income to guarantee their permanence in power through a populist approach to public policy. This approach may include tax reduction policies and an increase in welfare programs.
<b>Corruption Control</b>	<b>World Bank Governance Indicator</b> [0.44] 50 <sup>th</sup> – 75 <sup>th</sup> percentile Corruption transcends political and administrative spheres reaching many industries and economic sectors through all social-economic levels. Interaction between high government officials looking to get richer and common workers looking to support themselves has created an informal market that sustains the majority of the population and state resources.	
<b>Regulatory Quality</b>	<b>World Bank Governance Indicator</b> [-1.58] 0 <sup>th</sup> – 10 <sup>th</sup> percentile This shows a poor performance of the economic and political institutions, resulting in a weak development of the private sector.	
<b>Government Effectiveness</b>	<b>World Bank Governance Indicator</b> [-0.26] 25 <sup>th</sup> – 50 <sup>th</sup> percentile Although the government provides high quality social services, an inefficient bureaucracy, the interests of the Communist Party, and corruption hinder the effectiveness in the provision of such services.	
<b>Political Regime</b>	Cuba’s political system is a socialist unipartidism where power lies with the Communist Party. Elections are democratic, but in practice all behavior must conform to the regulations of the Communist Party.	<b>Repression Effect</b>  Due to the stability of the Cuban government, it is not likely for it to develop a repressive military apparatus. It is more likely that the government will manage oil revenues in a populist approach. It is not probable that the Cuban government will use force to oppress its people ergo the repression effect will not occur. In case the Cuban government does not manage oil revenues accordingly with the expectations of its people, it is likely they choose populist measures to appease their claims.
<b>Political Stability and Absence of Violence</b>	<b>World Bank Governance Indicator</b> [0.20] 50 <sup>th</sup> – 75 <sup>th</sup> percentile Cuba is politically stable because of the absence of violent opposition groups. The present regime has been in power consistently for the past 53 years without real domestic threats.	
<b>Voice and Accountability</b>	<b>World Bank Governance Indicator</b> [-1.54] 0 <sup>th</sup> – 10 <sup>th</sup> percentile Elections are transparent and have high participation rate. Nevertheless, basic rights like freedom of speech, press, and association are restricted because the Constitution forbids defamation, denigration, offense, or insult, among others, of government officials and state institutions in any form Also, the State controls most mass media.	
<b>Rule of Law</b>	<b>World Bank Governance Indicator</b> [-0.51] 25 <sup>th</sup> – 50 <sup>th</sup> percentile Cuba does not have separation of powers in the liberal sense; there are no checks and balances because the Constitution vests supreme power. This makes the judicial branch dependent and subordinate to other political powers.	<b>Modernization Effect</b>  Given that history has demonstrated that Cuba’s oil dependency has influenced political and economic policy, the modernization effect is likely to occur. Considering the habit to fall back into oil dependency, an increase in income may provoke the reallocation of public resources back into the oil industry. Furthermore, considering past tendencies, the education system may tend to specialize the labor force to benefit the development of the oil industry.
<b>Nation’s Wealth</b>	Gross accumulation of capital increased sharply by 21.9% in 2008 as a result of public policies implemented to maintain balance after three hurricanes struck the island’s economy in the same year. Repercussions were reflected in 2009 as capital accumulation decreased in growth by 19% and later by 7% in 2010.	
<b>Economic Diversification</b>	Cuba’s economy is not very diverse and is heavily dependent on the service industry, which accounted for 80.9% of GDP in 2010. This has caused the weakening of other areas like agriculture, construction, and mining and quarrying. Also, the high level of professional services exported to Venezuela and other countries has caused a slowdown in real GDP and low productivity in the state enterprise sector.	
<b>Oil Dependence</b>	Data from 1959-2003 show that there has always been an important relation between GDP, oil consumption, and oil imports. The most notable period of this was 1989-1993 when all three macroeconomic variables dropped significantly as a consequence of the interruption of oil imports from the Soviet Union. Even more, oil became Cuba’s second largest export in 2008.	
<b>Income Distribution</b>	<b>GINI Index (year 2000)</b> 0.38 The GINI index increased from 0.22 in 1986 to 0.38 in 2000 due to exceptional circumstances and shouldn’t reflect the reality of income distribution in Cuba.	
<b>Educational Level</b>	The education system is one of the country’s proudest accomplishments. The education index provided by Human Development Index (HDI) is the highest in Latin America and the Caribbean, 0.876, achieving the highest expected average years of education and the highest expected years of schooling in the region. Moreover, the adult literacy rate, in 2011, was 99.8%. It is worth mentioning that the education system provides for the professional medical personnel Cuba currently exports.	



## Conclusions

Under the assumption that Cuba becomes an oil – exporting country and, after careful evaluation of the thirteen variables chosen to represent Cuba’s political and economic systems, we conclude that Cuba has a potential to fall into the Oil Curse. It is probable that both the *rentier* and *modernization* effects will manifest in a future scenario.

Nonetheless, we recognize that given the nation’s unique political and economic position in the international scene, it is hard to foresee the outcome of the development of the Cuban oil industry. In addition, we must not forget the possible future impact of the guidelines approved by the VI Congress of the Cuban Communist Party in April of 2011. These guidelines aim to implement reforms in areas like employment, tax reform, and private sector to enhance self-employment, productivity, and economic growth. This investigation serves as an initial step to understand a currently evolving political and economic phenomenon which consequences are still unknown.

## Limitations and Recommendations

An analysis of the prospective effects of oil exploitation on the political and economic institutions of Cuba cannot contemplate all of its results without assuming that the oil industry, in time, will develop. Further investigation should expand to a quantitative analysis and related research in order to continue the analysis of the effective impact and development the oil industry may have on Cuba and its institutions.

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