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**An Overview of the Cuban Economy, the
Transformations Underway and the Prospective
Challenges it Faces**

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1. Results of the 1990s: Solutions and Prospective Challenges

1.1. What was so unique about the transformation that took place in the 1990s

Cuba entered the 1990s after having spent 30 years trying to develop under a socialist system that featured a highly centralised economy. This model was based on a pattern of international insertion that was totally dependent on sugar production and highly concentrated on just one country –the Soviet Union– which provided fundamental sources of energy, financial resources, about 85% of external demand for Cuba's sugar and more than 70% of its imports.

The fall of communism put Cuba in an unexpected situation of emergency and on the verge of economic collapse. Cuba was forced to retool its entire system of economic relations, beginning at the bottom. And it did so in a context aggravated by a tightening of the US trade embargo. The Americans were motivated by expectations that a domino effect might sweep communism out of Cuba as well.

Debate on the causes of the crisis that the Cuban economy faced has been extraordinarily broad, and it is not quite over. Within Cuba there are two extreme positions. One blames the crisis on the fall of the communist camp and the disappearance of the USSR; thus, it sees the origins of the crisis as being outside the workings of the Cuban system. The other attributes the crisis almost entirely to internal factors stemming basically from the poor performance of the system as a whole. Over time, more balanced (and also more reasoned) interpretations have emerged to shed light on the multi-factor nature of this process. To sum things up, the following are now widely accepted as being among the causes of Cuba's economic woes:

- (1) The depletion of a pattern of extensive growth divorced from the availability of domestic resources and the ability to gain access to external resources on an economically sustainable basis.
- (2) Structural deformations throughout the economy, with ramifications leading into the most important productive sectors.
- (3) Functional distortions between the macro- and micro-economic levels which prevented proper functioning of the state business system.
- (4) The magnitude of the impact associated with the sudden disappearance of Cuba's way of operating in the external sector (which was much more extensive than has usually been reported in the areas of trade, financial ties and technology), in particular because of its heavy dependence on the former Soviet Union.

However, the differing opinions on the causes of the crisis converge into unanimity when it comes to the issue of consequences. They include both the magnitude of the fall in production (an accumulated 34% over three years, from 1990 to 1993, comparable to the Great Depression of the 1930s in the US) and the imbalances that were triggered: a drastic reduction in utilization of industrial capacity (according to some estimates, in 1993 only between 12% and 15% of installed industrial capacity was utilised), a fall in foreign trade (more than 70%), expansion of the fiscal deficit (more than 150%) and record inflation, with an informal exchange rate that went from 7 to 150 pesos per dollar in a matter of months (at a time when the average nominal salary was around 200 pesos), just to cite a few of the most illustrative figures.

Therefore, it should come as no surprise that, in response to all this, a process of unprecedented transformation emerged. It was aimed first of all at rescuing Cuba's socio-political system in the new circumstances and, over the longer term, carrying out a deeper and careful reform of all economic relations, institutional structures and ways of formulating policy. This process is now in its second or third phase after more than 15 years of gradual change with a variety of dynamics; in some cases by strengthening or expanding the reforms that were introduced, and in others, by pulling back or freezing them, depending on the results and the perceptions associated with the changes.

This dynamic of adaptation and reform is often perceived as simply having a linear trajectory of opening –more or less gradual– that will lead sooner or later to a market economy. This error often prompts expectations that go unmet, and there are basically two causes: first, people have to realize that in actual practice what is under way in Cuba is a dual process of learning and shifting the limits of what is admissible and convenient; and secondly, it is wrong to automatically equate economic reforms with political change when in Cuba there is still no mechanism for breaking with or dismantling the structures of government.

From a historical standpoint, unlike the previous structural transformations (the first took place after independence from Spain, when the entire basis of the system of economic relations shifted towards the US, and the second came after the Cuban revolution, when it shifted to the USSR and the communist camp) in the process of change that began with the crisis of the 1990s we can discern some critical differences:

- (1) This time there is no 'global power' driving the transformation.
- (2) One thing that has set the Cuban economy apart was its nearly 'umbilical' dependency on the economies of major powers in their day.
- (3) Unlike in early periods of change, this time there is no 'global economic system' that is compatible with the Cuban system.
- (4) Even in the deepest of all its transformations, the one that started in 1959, which meant not only economic changes but also political and ideological ones, Cuba could always participate in (with varying degrees of success) a world economic system that served its aims. This time, that is not the case.
- (5) Therefore, there was no model either to serve as a historical reference for projecting into the future and correcting the present.
- (6) Albeit with differences, the building of socialism in Cuba followed (not always to a tee) the general socialist development model that was carried out in the Soviet Union. In this respect, the fall of European and Soviet communism shattered 'truths' in both ideological premises and the material realm. Cuba thus had to work on the basis of trial and error, carrying out experiments with extremely limited resources, with critical minimum levels, for which there were no early answers. Cuba was confronted by a lack of hands-on knowledge and experience for taking on the new challenges, improvised in some cases and above all faced circumstances of great urgency. This explains why, as recovery was achieved and the mechanisms introduced gradually consolidated, the authorities re-evaluated the scope of and need for these and this led to a partial withdrawal of some of the initial measures.
- (7) When Cuba lost external support, the process of rebuilding the economy on 'other bases' took on an unprecedented dimension and forced Cubans to seek new ways of efficiency and productivity to make up for at least some of that which was lost.
- (8) Perhaps as never before, the country needed to 'grow from within' and utilise sources that had never been contemplated before, such as expanding tourism, foreign investment and encouraging remittances and self-employment.
- (9) The US 'blockade' which, during the years of ties with the USSR –especially starting in 1975– was a 'latent threat' but a costly one in economic and financial terms, became in the new situation a real impediment to growth and development for Cuba.
- (10) Although it began in the early 1960s, Cuba's relationship with the USSR and its later, full incorporation into the CAME system allowed it not only to bypass the American market for one that was as big if not bigger, but also to gain access to cheap credit that facilitated significant progress on social issues.
- (11) The emergence over the past decade of Latin American governments that oppose US hegemony. Their political mantra in general has been about recovering national sovereignty in the face of multinational corporations, and tending to problems of social inequity that were triggered by the more or less passive application of programmes of economic openness and de-regulation. This exacerbated unequal distribution of revenue, problems with poverty and political instability. For Cuba, this raised previously unlikely opportunities for new economic ties.
- (12) The relative opening-up, albeit under very strict conditions, of trade in food and tourism from the US. This played a part in Cuba's re-evaluating its international economic relations and placing Canada and the EU in a less prominent position in this regard.

In this way, unprecedented conditions both at home and abroad have made the process that began in the 1990s one of the most richly nuanced and complex in the economic history of Cuba.

1.2. Adjusting to Growth and Structural Change Stemming from the Crisis

A look at these 18 years of evolution in the Cuban economy allows us to identify at least three important phases.

From 1990 to 1993: Crisis and Adjustment

This was a period of full-blown economic crisis, which manifested itself in a decline in all macro-economic indicators, although with differences in the speed and magnitude of the drops. It is also the period in which major imbalances in the system emerge (or existing ones expand in an unusual way), as a result of the crisis and a slow response in terms of designing new economic policy. What this policy did was to favour material adjustments (repeated cuts in inputs and equipment due to a supply shortage) rather than functional changes (through monetary, fiscal and foreign-trade tools) and structural changes necessary to increase supply.

But one should not interpret this period in a mechanical way, because as early as the late 1980s the government began to carry out important 'experiments' in the tourism sector and with foreign capital (in tourism).¹ Also, a few years earlier, changes began in the business model of the Armed Forces. These sought to introduce 'modern' management methods and give state-owned companies a degree of autonomy and flexibility that until then were unheard of in the Cuban economy.²

In the early 1990s the government decided to decentralise Cuba's foreign trade. Until then, it had been concentrated in a few dozen companies, most of which belonged to the Foreign Trade Ministry.

In June 1993, Cuba stopped making it a crime to possess dollars, creating a dual economy partially based on the American greenback. Besides the political and ideological impact (it not only meant it was legal to possess dollars, but that possession of the American currency was no longer a political issue) this measure had a major effect on the economy: the pattern of accumulation of money shifted towards the dollar and this benefited sectors engaged in more activities³ in the dollar-based part of the economy.

In the summer of 1993 the first structural measure is approved: the creation of the Cooperative Basic Production Units (UBPCs in Spanish), under which a significant part of the land that was in state hands is handed over to workers collectives in a free, open-ended usufruct arrangement.

By sectors, production and export of sugar are the driving force behind the economy and one of the sources of financing for the nascent expansion of the tourism industry.

From 1994 to 1999: Growth and Structural Change

Starting in 1994, the economy began a process of growth that continues to this day. At the same time, the economy moves toward de-centralisation and there is more room for market-style relations and direct foreign investment.

This is also the period in which Cuba shifts from an economy based on a product of primary industrialisation (sugar cane) to services (tourism) based on the country's natural advantages (geographic location, good weather, sun and beaches).

Important things happen. On the one hand, there is a process of industrial repositioning as a result of the financial restrictions that the country faces. The industrial sector is forced to adjust to the foreign currency market (tourism and stores that accept dollars). A process of change in social strata is consolidated (also because of people's access to dollars) and this gives rise to inequities that clash with the values of the Cuban revolution. This is also linked to the deterioration of the major programmes that Cuba's social equality had been based on since 1959: free, universal health care and education and generalised subsidies for everyday foodstuffs.

¹ In 1988, the first joint venture company is founded, by Cubanacan S.A. and Grupo Sol to operate a hotel in Varadero.

² This is the historic precedent of what later came to be known as *perfeccionamiento empresarial* (entrepreneurial improvement).

³ This segment of the economy was called the 'emerging economy'.

Although these programmes were not abandoned altogether, there were not sufficient resources to fund them properly. In fact, their decline accounted for part of the recovery cost undertaken in advance by the government.⁴

By the end of the 1990s, Cuba had stabilised economic growth (3.4% a year on average in the period 1994-99) with consolidated macroeconomic balances, albeit highly sensitive ones, in particular due to the existence of three currencies in circulation (the US dollar, the Cuban peso and the convertible Cuban peso)⁵ and two exchange rates.⁶

Two new engines of growth emerged, along with sugar production (which began to decline around 1996) and tourism (growing robustly): remittances (mainly from the US) and foreign direct investment. Discretionary handling of the latter allowed the government to concentrate it in sectors that were key to rebuilding the economy.

In this way, after 30 years of development efforts that failed to end Cuba's dependence on production and exports of sugarcane, the crisis that began in the 1990s is paradoxically the one that led the country toward diversifying its sources of economic growth.

Table 1. Measures introduced (between 1988 and 1997)

Measures
Opening up to foreign capital (1988)
Development of tourism (1988)
Modification of Decree 50 (1991)
Decentralisation of foreign trade (1990)
De-penalisation of possession of dollars (6/1993)
Creation of UBPC (1993)
Downsizing of State and government (1993)
Fiscal adjustment programme (1994)
Tax law (1994)
Resolution 6/1994 by the Labour Ministry
Opening up of agricultural markets (1994)
Opening up of market for industrial products (1994)
Extension of urban self-employment (1992)
Law on foreign investment
Opening of currency exchange firms
Business restructuring
Development of tax law (1996)
Start of banking reforms (1997)
Entrepreneurial improvement

From 1999 to 2007: Functional Adjustments and Growth

Starting in 1999, signs appear that indicate the start of a functional adjustment, again in the direction of more centralized ways of running the economy. The climax of the process is the creation of the *Cuenta Única del Estado*, or single state account, and the creation of the *Comisión de Asignación de Divisas*, or Commission for Allocating Foreign Currencies. But the Entrepreneurial Improvement Process (the goal of which was to create a regulatory framework allowing state companies to attain higher levels of productivity and efficiency) also enters a prolonged period of lethargy. The government also modified terms for foreign direct investment (this first involved a freezing of investments in the real estate sector, and then the re-purchase of these by two state-owned companies, CUBALSE and CIMEX). It gradually reduced the number of joint ventures in operation and concentrated them in activities and sectors that were essential for Cuba. Finally, the government raised the level at which decisions on the sector were taken, and toughened requirements for branches of foreign companies.

⁴ From the outset of the so-called Special Period, the government warned of the need to put off some social development goals.

⁵ The convertible Cuban peso was introduced in 1994 and at first the government only issued them against physical dollars as backing (at the rate of 1 to 1).

⁶ The official exchange rate (1 dollar = 1 Cuban peso) and the unofficial, or CADECA rate (1 dollar = 26 Cuban pesos).

Furthermore, Cuban authorities ordered a substantial reduction in the number of Cuban companies with the right to engage in overseas trade, and centralised a large part of imports in a small group of companies in order to lower the cost of much of the purchases that Cuba made abroad.

In 2004 and 2005, the government stopped letting Cuban companies bill each other in dollars, and the CUC currency came to be used for this purpose. A few months later, the government halted use of CUCs for billing of consulting and other services among Cuban companies.

Another sector where the government cracked down was that of self-employment. It reduced the variety of ‘professions’ allowed and restricted (or eliminated) the granting of licenses for a group of activities. Over the mid-term, these moves have generated a greater concentration of wealth in the sector.

From 1999 to 2007, two periods can be clearly distinguished: (1) one corresponding to the beginning of the decade (from 2001 to 2003), with meagre economic growth that did not surpass a yearly average of 3%; and (2) a period corresponding to 2004-07, with average annual growth of 6.1%, and in which there was an unquestionably positive effect from the opening of the Venezuelan market to services from Cuban doctors; Cuba started importing Venezuelan oil at subsidised prices, and the two countries consolidated cooperation and business projects, under the framework of ALBA, the Bolivarian Alternative for the Americas. This period also saw an increase in trade, with China and Cuba’s gaining access to mid-term credit lines that had a positive impact on economic growth and upgrading of services and infrastructure (transport –both passengers and freight– buses, railways and trucks) and investments in mining and other sectors.

The Chinese presence has had a considerable effect, although perhaps one that is less noticed than that of Venezuela because it shows up in a lesser relative proportion. However, China has become one of Cuba’s strategic international partners.⁷ In 2003, it was already Cuba’s third-largest trading partner, surpassed only by Venezuela and Spain, with US\$300 million in exports to Cuba (electronic appliances, machinery and telephone equipment) and imports just above US\$121 million (tobacco, chemicals, high-tech medical equipment, vaccines and fish). No less important are mining investment projects (such as nickel, of which Cuba has the world’s second-largest reserves) which in a short span of time will allow Cuba to double its export capacity, and joint projects with Venezuela in sectors such as infrastructure for transporting fuel (ducts in the country and the Cienfuegos base –the latter will give Cuba a strategic position in the Caribbean–) and generating electricity.⁸

1.3. Macroeconomic Performance

Debate on Cuba’s economic performance in these years has been profuse and rich in contrasting positions, which makes it difficult to reflect in just a few lines. The debate has addressed everything from economic statistics themselves and their availability to the methods used to calculate some of the main indicators, whether those indicators can really reflect all that is happening in the actual economy and are compatible with figures from other countries, and issues more linked to the performance of the economy as seen through the behaviour of those indicators.

This report does not aim to get involved in that debate, much less seek to establish where the limits of truth and reason are. We only note that:

⁷ Jorge Mario Sánchez Egozcue and Lourdes Regueiro, ‘Latin America vis a vis the FTAA: Between Relaunching and Alternatives’, in G. Prevost & C. Oliva (Eds.), *The Bush doctrine and Latin America*, Palgrave Macmillan, New York, 2007.

⁸ *BBC Mundo.com*, ‘Chávez estrecha alianza con with Castro’, 28/IV/2005.

- (1) Changing the base year for prices (from 1981 to 1997) was, in our opinion, essential because the structure of the economy and the method of establishing prices and costs in 1981 had nothing to do with the reality of the Cuban economy in the mid-1990s, even though this change did introduce the difficulty of having two series of numbers with different base prices. This problem has been resolved to some extent by reconstructing series heading backwards in time.
- (2) The GDP calculation method introduced in 2004, which had the goal of reflecting more accurately the country's real efforts in sectors key to growth and development,⁹ has allowed for building the GDP data series from 2000 to present. But it has not been 'continued heading backwards', which forces us to break the analysis up into two periods (1990-2000 and 2001-07). Naturally, this carries with it problems.

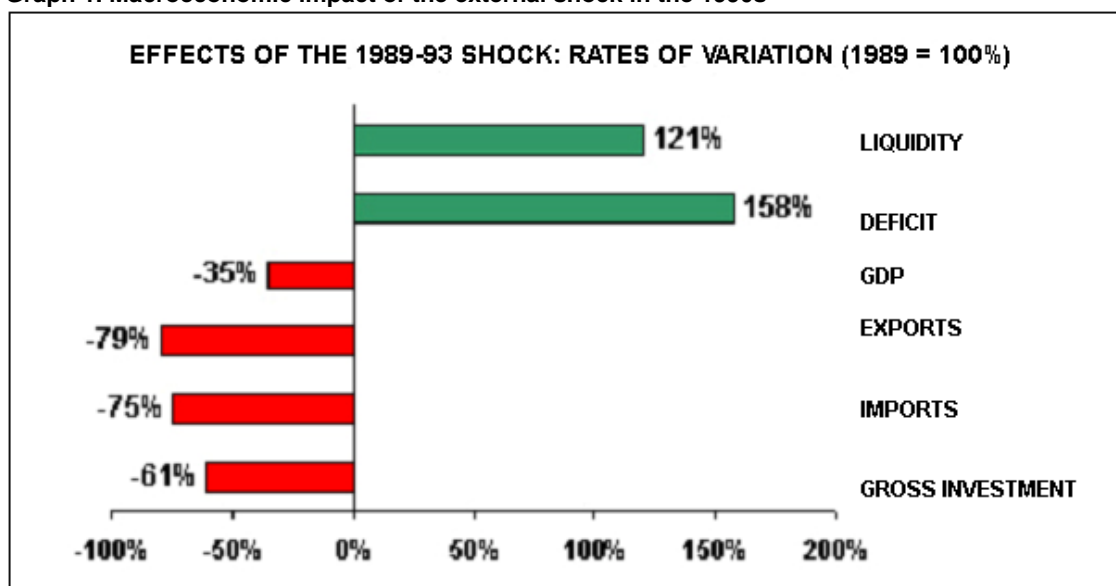
The period running from 1990 to 2000 has been widely studied and documented in research papers both inside Cuba and abroad. So here we will only point out a few salient points.

Fall and Recovery of GDP

The sustained fall in GDP from 1990 to 1993 clearly stemmed from the combined effect of two factors. The first was of a structural nature (structural deformations that were not resolved by development strategies undertaken until 1989, or ones that emerged with those strategies). The second was linked to the first but more of a circumstantial nature (the fall of the overseas sector).

As for the first factor, today it is clear that despite its efforts to develop from 1959 to 1989, Cuba failed to shed a group of characteristics typical of any underdeveloped country: 'The combination of those structural obstacles that the various development strategies could not eliminate, the same ones that consolidated a pattern of extensive growth and functional insufficiencies, the ones that caused rigidity and slowness in correcting the mechanism of how things worked, both at the macro- and microeconomic levels, is the basis for the deepening of the crisis that erupted in the 1990s with the disappearing of the communist camp and the Soviet Union. These events gave the crisis new features. Taken altogether, these obstacles are the true causes of the crisis, in the same way that its depth is linked specifically to the disappearance of the communist camp'.¹⁰

Graph 1. Macroeconomic impact of the external shock in the 1990s



Source: Anicia García, CEEC, University of Havana, 2007.

⁹ The need to perfect GDP accounting does not apply exclusively to Cuba. In fact, it is an ongoing process being carried out by a United Nations commission.

¹⁰ J. Triana Cordoví, 'Cuba, transformación económica 1990-1997: supervivencia y desarrollo en el socialismo cubano', doctoral thesis, 1999.

In summary, some of the main features of the economy that allowed GDP to stagnate and later decline were:

- Deformation of the economic structure.
- Low capacity for generating domestic savings.
- Low levels of productivity and competitiveness.
- International insertion on the basis of products with low added-value.
- Unilateral dependence on just one market and just one product.
- A weak industrial system.
- Fiscal imbalances.

Regardless of any debate on the statistics (reliability, whether they can be compared to those of other countries, etc.), there is no question about the magnitude of the crisis and the depth of the impact that the external sector had on the Cuban economy in the period 1989-93.

The period 1994-99 corresponds to the start of a process of recovery that was relatively modest in quantitative terms (the average annual growth rate was 3.4%) for those years, but significant in qualitative terms because the foundations for it were substantially different. Unlike the years prior to 1990, in which supply played a significant role in growth through imports (mainly from the USSR), this time it is aggregate demand that will play a decisive role (through tourism, remittances and foreign direct investment). This made for a different growth pattern, one linked to the availability of foreign currencies and access to the foreign currency market. In real terms this forced a restructuring of the Cuban system of production, yielded winners and losers within the state sector and made unprecedented room for businesses to jump in.

In the case of the period 1994-2001, the total productivity of the PTF factors was the most important issue for explaining the economic growth of those years. Not all of this growth can be attributed to 'knowledge', but it is important to note how the contribution made by the other factors is the lowest of any period. Certainly, increased foreign demand through rises in tourism and some exports, like nickel and tobacco in the second half of the decade, played an important role. But that growth was achieved with very low levels of investment and also with low levels of job creation.

Table 2. GDP growth from the perspective of production factors

Period	GDP (1)	Capital	Work force	Human Capital	Total Productivity of the Factors
1961-1967	4.99	0.61	1.11	0.84	2.43
1968-1970	1.19	1.16	2.95	2.67	-5.59
1971-1985	6.84	2.82	0.7	1.95	1.37
1986-1989	0.5	3.43	2.22	0.54	-5.69
1990-1993	-10.13	0.3	0.6	0.43	-11.46
1994-2001	3.63	-0.91	0.3	0.36	3.38

(1) GDP growth rate calculated with Purchasing Power Parity

Source: Oscar U-Echevarría, lectured delivered at the seminar '25 Years of INIE', 2003.

Another factor to take into account is the volatility of growth. During these six years, the GDP growth rate experienced significant changes. Even using the data series that runs until 1993, the last year in which it was published with the traditional methodology, the volatility of Cuba's economic growth is even more evident. Here again we see a coincidence in that one of the factors that caused this is the behaviour of the overseas sector.

The final result of these years is that, on one hand Cuba managed to restore fiscal and monetary solidity, the purchasing power of wages improved in comparison with the deteriorated levels of 1993 and 1994 and the known, or open, unemployment rate dropped below 6%. But on the other hand, distortions emerged which hindered and continue to hinder the economy's capacity for growth. They include:

- Two currencies in circulation.
- Two exchange rates.
- Wage stagnation and a fall in real wages.
- Concealed unemployment.
- Poorly structured supply.
- Distortion of relative prices.

1.4. Diversifying the Engines of Growth

Even before 1959,¹¹ Cuba's heavy dependence on sugarcane production was identified as one of the reasons for its economic problems. Paradoxically, Cuba's development efforts prior to 1959 made it even more dependent on sugar production,¹² not only in terms of export revenues but also the production chains that the industry generated.¹³

The loss of the sugar market and the lack of another market to replace it meant that from 1990 to the present Cuba had to diversify its sources of economic growth, although in essence the external component continued to be decisive in this respect.

From this point on, tourism, remittances and foreign capital became the main sources of economic recovery. The novelty of Cuba's long-standing dependency on the overseas sector is linked to three factors: (1) three new engines for growth emerged; (2) there was a substantial difference in terms of backward-moving ripple effects which were caused by tourism (and the foreign currency market in general) and which has forced the Cuban industrial sector not only to restructure (as a necessary effect of the crisis and the lost of sources of financing and 'traditional' technologies) but also to modernise in order to satisfy new demands for quality and diversity and be able to compete (both for the tourism market and the domestic market in foreign currency) with foreign production;¹⁴ (3) the 'pattern of accumulation' changed; not in its essence, since access to external savings has been and continues to be decisive, but rather in the way it is accessed and used (Cuba went from access and disposition that was centralised and decided from above to a model in which initiative and use under certain margins of flexibility were decisive and allowed for adjustments, depending on efficiency and productivity. The model worked into the early years of this new century); (4) the pattern of industrialization shifted, from production of intermediate goods and capital (whose final destination was the sugar industry) to production of low-tech consumer goods and also goods with a low level of integration in the reverse sense, in many cases (perverse modernisation). Nonetheless, the shift allowed for recovery of much of the industrial sector; (5) the domestic market (operating in foreign currency) became critical in this dynamic of economic recovery.

From the standpoint of sectors, what the 21st century adds to the impetus for growth are the emergence of nickel as an important source of revenue from abroad, and in the last five years, that of health-care services and the biopharmaceutical industry as sources of revenue for growth. Unlike sugar and tourism, these three areas are highly concentrated within themselves, with very little capacity for generating ripple effects moving forward or backward, although for different reasons.

¹¹ The Truslow Report of 1950 (International Bank for Reconstruction and Development), for instance, was accurate with regard to Cuba's dependence on sugar production and need for diversification.

¹² The USSR paid an average of 36.4 cents for a pound of sugar in the period 1975-89 while the price on the world market during that span was 11.49 cents (see J.L. Rodríguez, *El desarrollo económico y social de Cuba*, 1990, p. 292).

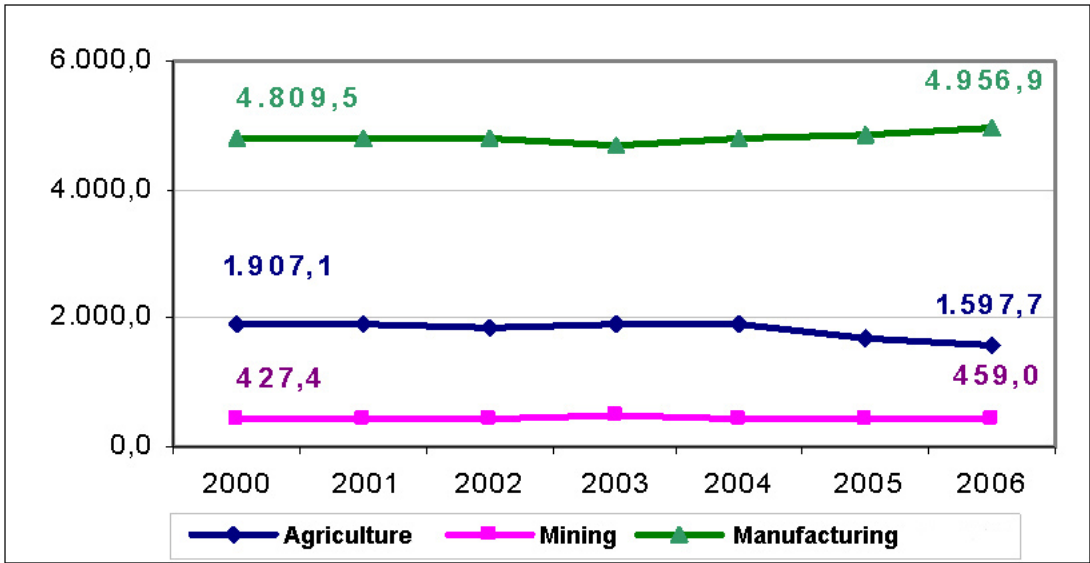
¹³ The sugar industry accounted for 14% of Cuba's mechanical production and was also the final destination of 20% of all non-sugar-related mechanical production, 13% of basic industry and 8% of light industry.

¹⁴ The scope and role of competition in the transformation that occurred in the 1990s is one of the issues that have been explicitly debated the least in terms of theory. Today, it is once again one of the most important and also most complex theoretical and practical subjects; it is not only associated with the old discussion over opening up versus protectionism. Rather, in the case of Cuba there is the added argument (implicit and explicit) over free markets versus a planned economy.

In the case of nickel, the mineral is located in Cuba but refined abroad and this limits the multiplying effect it might have for the national economy. As for biopharmaceuticals, which have an unquestionable strategic importance in the immediate future, the demands posed by the inputs needed to produce bio-technological medicines mean the Cuban industry has few opportunities to supply them. And with regard to the health-care services that Cuba exports, mainly to Venezuela, its direct impact on production is limited.

However, the improvement that exports of nickel and medical services has triggered in the balance of payments opens up opportunities for a re-launching of goods-producing sectors (agriculture and manufacturing), which had been in a clear state of decline between 2001 and 2006.

Graph 2. Performance of chosen sectors (1997 prices)



Source: *Anuario estadístico de Cuba*, National Office of Statistics.

The recovery of these sectors is vital for the present and future of the country; first, because they allow for the creation of productive jobs, and secondly because of their impact on the trade and balances of payments by replacing imports.

1.5. Diversification of Forces and Interests

As a result of the transformations stemming from the reforms of the 1990s, we can identify at least four general kinds of forces whose interests do not always coincide, despite state regulation:

- (1) The ‘emerging’ sector of state-owned, foreign and joint venture companies which, for the most part, operate in convertible currency –the CUC–. The sector includes foreign investment companies which, although they do not account for a large proportion of GDP, in actual practice they have a high impact role in generating revenue in foreign currency, upgrading technology and management techniques, as well as in employment in the sectors which have been the most dynamic in recent years.
- (2) The state sector, with more than 3,000 companies and entities. It encompasses many kinds of firms, from those providing subsidised services and products to those which operate with financing and market operations in both currencies.
- (3) The cooperative sector –mainly agricultural– which, along with private farm producers, is the focus of the most recent transformations.
- (4) Private producers (rural and urban) that include producers of tobacco, sugar, specialised crops, small-scale haulers and no fewer than 112 legalised forms of self-employment. In cities, such workers absorb little of the workforce and tend to show a preference for services (tourism

lodgings, restaurants and transport), in addition to many other professions (carpenters, plumbers, construction labourers, repair crews, etc.).

As can be understood, it is almost impossible to reconcile the interests of all these different sectors because the conditions in which they operate are quite different (to wit: market orientation, currency, prices, regulations, etc). Although the State acts as a regulator and intermediary by planning strategy and redistribution, tensions remain. They stem naturally from the differences in operating environment.

Other discrepancies are simply the result of administration techniques. This means the process of transformation has a dual mission. On one hand, it must prevent a widening of the gap between the sector that generates foreign currency and the one that receives it through allocation. The goal of this is to avoid consolidation of deformations in a *rentista* style culture that conspires against efficiency and general sustainability of growth. The other mission is to modify incentives, regulations and administration methods, which have serious problems of compatibility.

All of this confirms the complexity of the task of reforming the environment in which these economic forces operate, and, therefore, the need to undertake the process in such a way that the effects of reforms can be distributed over time and digested gradually.

2. What Kind of Economic Reforms Are Expected, And In Which Sectors?

There are two reference points for the direction and content of Cuban economic reform.

One of them is advocated from abroad, and its most extreme manifestation is found in studies produced in Miami, Florida. According to these studies, the only changes should be those that are part of the political agenda of a minority with extreme positions that are far removed from the reality of Cuba. Its fundamental limitation is a lack of knowledge of Cuban institutions, which in the end are the ones that will carry out this task. As Rafael Rojas said in March at the Casa de América (Madrid): ‘the possibility of opposition and exile groups having an influence on the dynamics of change in Cuba could be thwarted if these sectors continue to not recognize the legitimacy of the government in Havana’.¹⁵

At the other extreme are the ideas of the Cuban government, which favours a gradual, articulated and consensus-based approach with a more pragmatic style. This represents a qualitative change. As the foundation of internal consensus, the government continues to insist on defending social justice and national sovereignty. It also accepts a process of change in the bases of its leadership to more collegiate forms. These would be complemented by renewing institutional structures and reactivating solutions at the local level by empowerment of such organisations and progressively decentralising the management of resources.

Perhaps the most significant aspect of the political climate in which change is being promoted was the call for a national debate in which more than 5 million Cubans expressed their criticisms and points of view on the country’s needs and problems. These were collected in around 1.2 million suggestions, which form the immediate basis of granting legitimacy to the proposals for change which came out of that nationwide consultation.

In other words, the call for an open and critical dialogue on domestic issues took away from the technocracy the process of devising solutions and gave it a different stamp of transparency and interaction. On one hand, the process in and of itself is a factor that creates expectations, which later will have to be adjusted in line with the priorities which are set and the resources available to fulfil

¹⁵ Lenier González Mederos, ‘Construir un posible en la infinitud’, *Espacio Laical*, February 2008, p. 73.

them. At the same time, the process has served to re-articulate the domestic consensus on issues and define the nature and pace of reforms.

The issues debated ranged from bans and bureaucratic obstacles (for example, the ban on Cubans' staying at some hotels, or being able to travel abroad) to other, more fundamental ones that will certainly require more time and analysis, such as reforms in the agricultural system, opening up to foreign investment, restructuring production, the system of ownership, low wages and having two currencies.

With this call, the current government does not face a situation of renewing its political legitimacy, but rather one of maintaining internal consensus and support in order to give continuity and depth to the reforms that are under way. One special feature is that these reforms are not billed as a break with the past, but rather as displays of continuity and improvement within the institutional political system. So the call for Cubans to voice criticisms turned out to be in actual practice a *de facto* referendum on the need to carry out reforms and support the new government.

A synthesis of the measures taken so far would go as follows:¹⁶

- Elimination of a ban on Cubans who live on the island staying at hotels that cater for tourists.
- Making cell phone services available to all Cubans.
- Allowing sales of computers and electrical appliances.
- Streamlining of procedures for civil servants to buy homes that belong to state-run entities.
- Ceding land to private farmers and cooperatives in order to boost production of food, coffee and tobacco.
- Decentralisation of decision-making on agriculture and sale of farm inputs in convertible currency.
- Cancellation of farmers' debt and a rise in wholesale prices that the State pays for milk, meat and potatoes.
- Reactivation of the process of improving the state business system.
- Increase in pensions and wages for sectors chosen in a progressive way.¹⁷
- Recognition of payments to Cubans working for foreign companies, along with expansion of tax contributions.

Some of these measures have an undeniable effect on production, while others are of a more limited nature. However, taken altogether they have a positive influence on reforming the economy.

2.1. Growth: Centralisation and Decentralisation

In general, studying the process of economic growth in Cuba has been overshadowed by a much broader issue, that of development of the country's economic system. In this way, studies of growth have been secondary to and dependent on other analyses.

¹⁶ Version based on *BBC Mundo.com*, 'Cambios y expectativas', 29/IV/2008, and *Prensa Latina*, 'Cuba incrementa pensiones y asistencia social', Havana, 27/IV/2008.

¹⁷ This is the case of retirees and wages of employees in the judicial branch. Starting in May there will be an average 20% rise for more than 2,154,000 people covered by social security and health care, at an annual cost of 809 million pesos. The government also plans to raise the wages of nearly 10,000 workers at the People's Supreme Court and the Attorney General's office; in general it will be a raise of 211 pesos on average, and 425 for judges and prosecutors. The annual cost of this measure will be 27 million pesos and the average wage in the judicial sector will go from 360 to 559 pesos, a rise of 55%. The increase in pensions will affect 99% of Cubans with such coverage. The government has announced a minimum pension of 200 pesos (before it was 164), while those who used to receive between 202 and 360 will now get 40 pesos more.

There are few doubts over the urgency of Cuba's growing and doing it in such a way that the growth paves the way for development. One issue always present in this debate is the relationship between growth, centralisation and decentralisation. It is all about the effect that the regulatory framework has on economic growth. This is an old subject of discussion in Cuba and one that comes up again periodically.¹⁸ It is naturally associated with the 'pendular movements' of regulations. However, most studies done until the 1990s did not use address this as a central issue.

A new wave of studies on this began to appear in the mid 1990s and, not by accident, they coincided with the last of the changes in the Cuban regulatory cycle.¹⁹ The novelty of some of these studies is the effort they make to capture the relationship between the regulatory framework and growth from the perspective of the accounting of growth, and to create a theoretical and instrumental framework that allows for greater objectivity in the analysis of this link.

Cycles of growth have been identified which are associated with total productivity of factors. These cycles essentially confirm the decisive role of the accumulation of factors in the growth experienced by the Cuban economy. Between 1971 and 1989, this growth was based on accumulation of factors. Starting in 1987 and through 1991, that style of growth faded away (if we look at the performance of total productivity). From 1991 to 2002, it was gains in productivity which sustained growth. Among other reasons, these gains were triggered by changes in the regulatory context (a shift towards greater decentralisation).

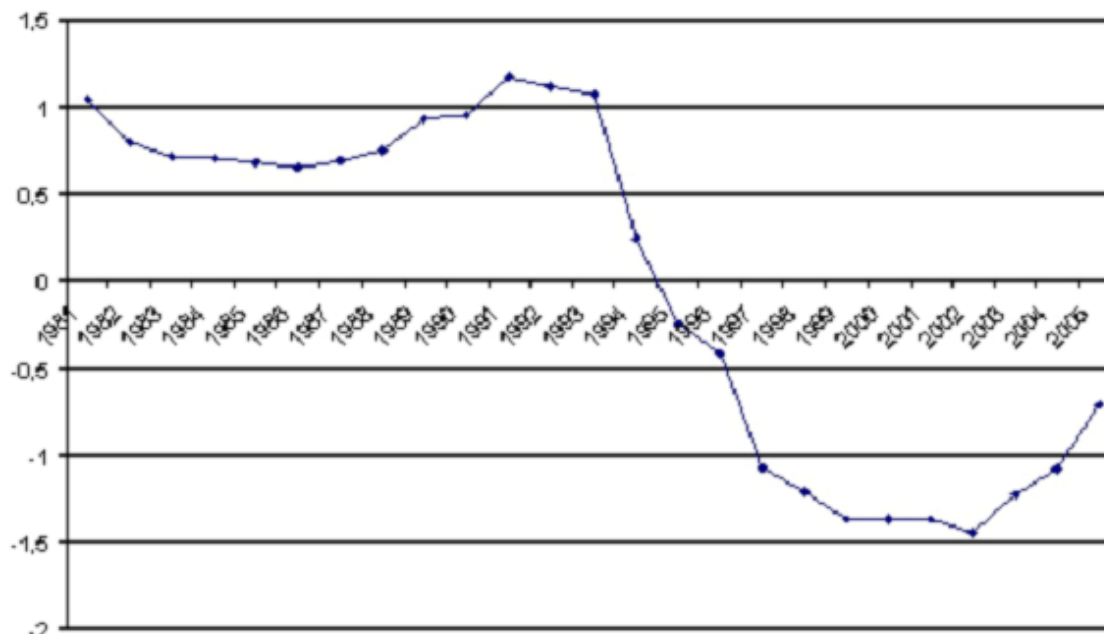
Efforts to understand the link between growth and the regulatory framework led to important results that help interpret what kind of future might await Cuba. In this regard we have identified stages in the regulatory cycle starting in 1980:²⁰ 1980-86, decentralisation; 1987-91, centralisation; 1992-2001, decentralisation; and 2002-05, centralisation (in this last case, the authors of this study believe this phase may have stretched into mid-2007).

¹⁸ See Vilariño & Domenech, 'El sistema de dirección y planificación de la economía en Cuba'; Acosta Santana, 'Teoría y práctica de los mecanismos de dirección de la economía en Cuba'; González, 'Modelos económicos socialistas: escenarios para Cuba en los años 90'; Carranza, Gutiérrez & Monreal, 'Cuba: la reestructuración de la economía. Una propuesta para el debate'; and Triana Cordoví, 'Cuba: transformación económica 1990-1997, supervivencia y desarrollo en el Socialismo Cubano'.

¹⁹ Y. Prado, 'Marco institucional: influencia en el crecimiento productivo en Cuba', School of Economics, University of Havana, 2006, and Yaima Doimeadios, 'Un modelo de crecimiento económico para Cuba: un análisis desde la productividad de los factores', School of Economics, December 2007.

²⁰ Yaime Doimeadios, *op. cit.*

Graph 3. Compound index of Centralisation



Source: Yaima Doimeadiós, 'Un modelo de crecimiento económico para Cuba: un análisis desde la productividad de los factores', doctoral thesis, School of Economics, December 2007.

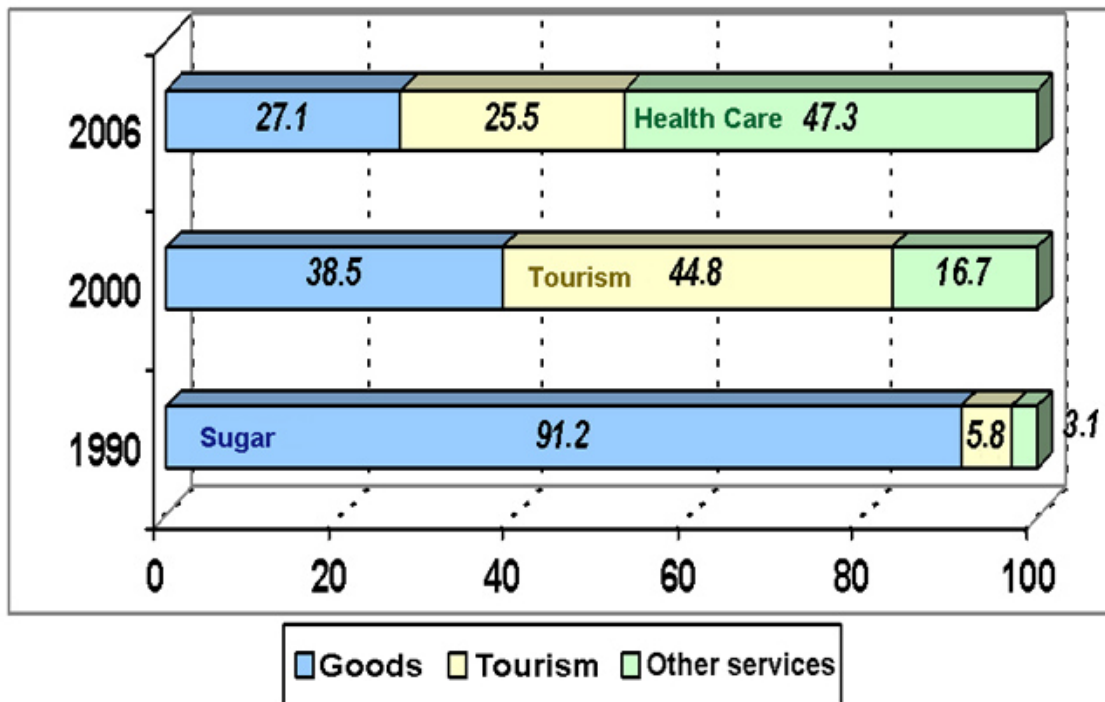
The relevant aspect of these studies and the realities they reflect are associated with the dilemma for the present and future. To wit:

- (1) If the empirical observation of the inverse link between centralisation and total productivity of the factors as seen in this latest generation of studies is accurate, then one has no choice but to accept the need to decentralise decisions on the economy and give more leeway and power to economic forces at the ground level.
- (2) One can confirm that the way in which centralization was carried out in the past competed with growth by reducing gains in productivity.
- (3) However, on the other hand, it is also possible to confirm that the way in which decentralisation was carried out –even though it allowed gains in productivity– triggered losses in the efficiency of re-distribution, due to weak or inadequate regulatory systems. This, in turn, created negative incentives in the workplace and processes of social stratification that go against the nature of the socialist model.
- (4) As Cuba is a poor and underdeveloped country, and subject to a US trade embargo, and with growth restricted by its balance of payments, achieving gains in productivity and efficiency are decisive for the country's present and future.
- (5) As is the case in any process involving change –the current one and the one that will come in the future, after 2008– the relationship between 'winners and losers' must be such that the latter do not feel their loss is absolute. To do this, it is essential to make production grow. If centralised-style regulation competes with this, then over the long term its results will not be sustainable, neither in economic nor social terms.
- (6) In sum, economic growth in conditions of under-development and lack of natural resources requires substantial increases in total productivity and efficiency. The recent history of Cuba – the actual facts– show that centralisation (at least the way it was carried out in actual practice) leads to major losses in both categories, even if GDP grows.

2.2. Structural Change in the External Sector and in Growth

Starting in 1990 and to this day, there have been significant structural changes in Cuba that are expressed in at least two dimensions: which sectors contribute to GDP and a shift in the makeup of exports.

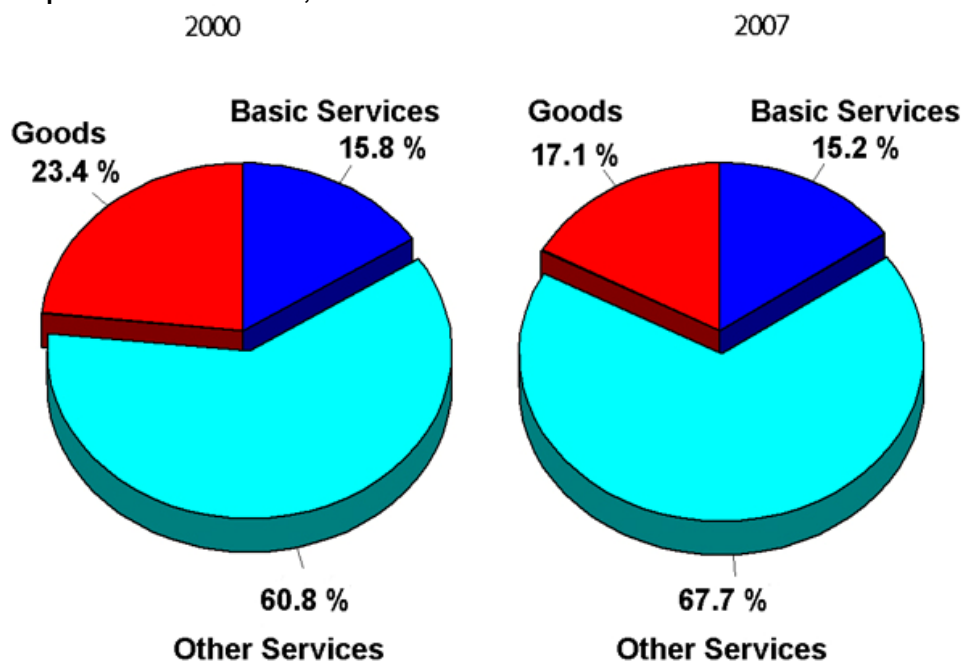
Graph 4. Change in the structure of overseas trade: from sugar to services (export revenue in %)



Source: Jorge Mario Sánchez-Egozcue, 'Panorama de la economía cubana', presentation for the Canadian International Development Agency, February 2008; done with data from AEC-ONE.

As for the structure of GDP, the contribution from the service sector has become decisive.

Graph 5. Structure of GDP, 2000-07



Source: ONE, *Panorama económico y social 2007*, February 2008.

While it is true that the methodology used to calculate GDP as of 2000 favours the service sector, it is also true that expansion in this area has been on average greater than that of sectors involving production of goods as of 2000. This is the result of the priority placed on re-launching social programs.

Table 3. Dynamics of growth in goods-producing sectors

	Growth 2000-06 (%)	Average annual growth 2000-06	Growth 2006-07 (%)
Agriculture	83.70	0.97	24.70
Mining	107.39	1.013	4
Industry	103.06	1.05	7.80

Source: calculations based on *Anuario estadístico de Cuba*, 2006, and *Panorama económico y social*, 2007, 2008.

The loss in relative weight experienced by productive sectors (agriculture and manufacturing) is directly associated with the dynamics of very low sectoral growth. This must change in the immediate future if Cuba wants to reverse the situation with regard to its foreign trade imbalance and total productivity. This is because the service sector which has led growth is characterized by involving activities which are labour- intensive in relative terms and geared mainly toward final demand in domestic markets. These two features typically limit growth in productivity.²¹

Another interesting aspect is that, unlike other times when sales-oriented services reach important levels and attain productivity gains and accompany growth in the product that is gaining weight in the structure of this expansion, in the case of Cuba in recent years those (basic) services, with the exception of telecommunications, have not gained weight within the structure of the product. This can limit prospects for growth if that fall in contribution corresponds to a continued decline in the infrastructure necessary to attain sustained increases in efficiency and total productivity or to a fall in the processes of outsourcing of the economy.

With regard to the relationship between structural change, growth and development, where there seems to be an accepted consensus that ‘overcoming the structural deformations in an economy is something that happens over the long term’ and ‘change in the productive structure is what allows a greater deepening of the division of labour, specialisation and growth in productivity, as well as gradual expansion of more sophisticated activities’,²² major questions remain as Cuba looks to the future. In particular, the study mentioned above, which covers the period 1975 to 2003, points out the following problems:

- (1) A lack of direct correspondence between the periods of greatest transformation in the makeup of production and those of greatest economic growth.
- (2) Inconsistencies between transformations at the value-added level and those that take place in employment.
- (3) At the same time, this triggers negative effects in added productivity, making it hard to sustain high rates of growth.

Addressing these issues and the challenges Cuba must face in the future, questions arise which must be resolved properly if the country is to follow a sustainable path:

- Can Cuba keep providing more social services without a corresponding expansion in goods-producing sectors with gains in productivity?
- Is it possible to keep creating jobs with systematic drops in productivity?
- Is it acceptable over the short term to pay for the necessary expansion of the primary sector with drops in total productivity, or is it possible to avoid that loss by implementing change and technological modernisation?

²¹ R. Torres Pérez, ‘Cambio estructural y crecimiento económico en Cuba: un enfoque a partir del uso de los factores productivos’, Center for Studies of the Cuban Economy, 2007.

²² *Ibid.*

And if this is the case,

- Where will Cuba find the sources of accumulation to achieve this modernisation? Just in the state sector, in the state sector and the private economy, or through foreign direct investment?
- Is it possible to expand the manufacturing sector at such a rate so as to avert a loss in total productivity from job creation in sectors with low productivity?

And if this is the case,

- Which segments of the economy should be promoted? Those linked to expansion of ‘tradable’ services (tourism and medical services)? And should Cuba wait for the ‘spillage’ from this to allow generalised expansion into other segments of the industrial sector, or should the expansion be undertaken in a sort of ‘broad front’?
- Where would the sources of accumulation be? In the state sector, in the state sector plus a possible non-state Cuban sector (cooperative and private) or in foreign direct investment, or in a combination of all of the above?

These are some of the questions that still need to be answered with regard to the issue of sustainability, although they are not the only ones that analysts are looking at. The current debate on the content and scope of the reforms that Cuba needs to make has moved in several directions, which demonstrates the vitality of the underlying proposals.

For instance, the need for structural changes is acknowledged. But it has been argued that it would be a process of restructuring in a broad sense, and would need to feature at least three kinds of transformation: (a) a redefinition of the material bases of accumulation (for example, the proportions of consumption and investment; the relative size and role of the different sectors such as agriculture, manufacturing and services; and the priority given to different branches of the economy); (b) rejoining the international economy (for instance, a new international specialisation; and (c) reform of the economic system (for example, the role of the market, state regulation of forms of ownership, and how businesses are organized)... what the Cuban economy needs most urgently is ‘reform’, before trying to undertake a more complete ‘structural change’.²³

However, most analysts do not see the dynamics of the process itself as one of rupture, but rather a gradual reform that might (or might not) have the effect of building upon itself, depending on the political perceptions that the process generates. As Ignacio Ramonet stated recently, ‘it is unlikely we will witness a Cuban version of *perestroika* or political opening or multi-party elections’.²⁴

For now, the *strategic priority* is aimed at recomposing the regulatory framework, incentives and structures, with an eye to breathing new life into and overhauling economic ties in the domestic realm.

In this way Cuba could ease the *tensions that are accumulating now* due to insufficient capacity to respond in current conditions in order to achieve an economic recovery robust enough to offset the negative factors. Of the latter, the following have been cited:

- Rises in prices of essential imported goods which Cuba has limited ability to replace with others (food and medicine).
- The strengthening of the US trade embargo, which has increased the cost of commercial and financial transactions.

²³ Pedro Monreal, ‘El problema económico de Cuba’, 2008.

²⁴ Ignacio Ramonet, ‘Fidel del primer al cuarto Poder’, *Kaosenlared.net*, <http://www.kaosenlared.net/noticia/fidel-del-primer-cuarto-poder>, 26/IV/2008.

- A low level of efficiency in construction and agriculture.
- Insufficient levels of overall productivity and workplace discipline problems (associated with excessive bureaucracy, rigidity in the regulatory framework and failures in the system that governs wages and incentives).
- Insufficient domestic production of foodstuffs, which forces Cuba to increase its imports at even higher prices.
- Delays and distortions in the carrying out of investment projects.
- The accumulated damage from several consecutive years in which severe weather (hurricanes and drought) caused severe losses.

The *priorities* stated by the government in its allotment of resources are:²⁵

- Construction (housing and recovery of the health care system).
- Infrastructure (energy and hydraulic networks –especially in the eastern part of the country–).
- Community services.
- Road repairs.
- Scaled and selected increases in spending on social security.
- Subsidies for foodstuffs in the rationed ‘basket’.

2.3. Handling Distortions: Markets, Prices and Wages

The emphasis placed on distortions that prevent greater growth of the Cuban economy and reduce incentives to work confirms that it is impossible to grow without proper macroeconomic functioning.

Segmentation of Markets

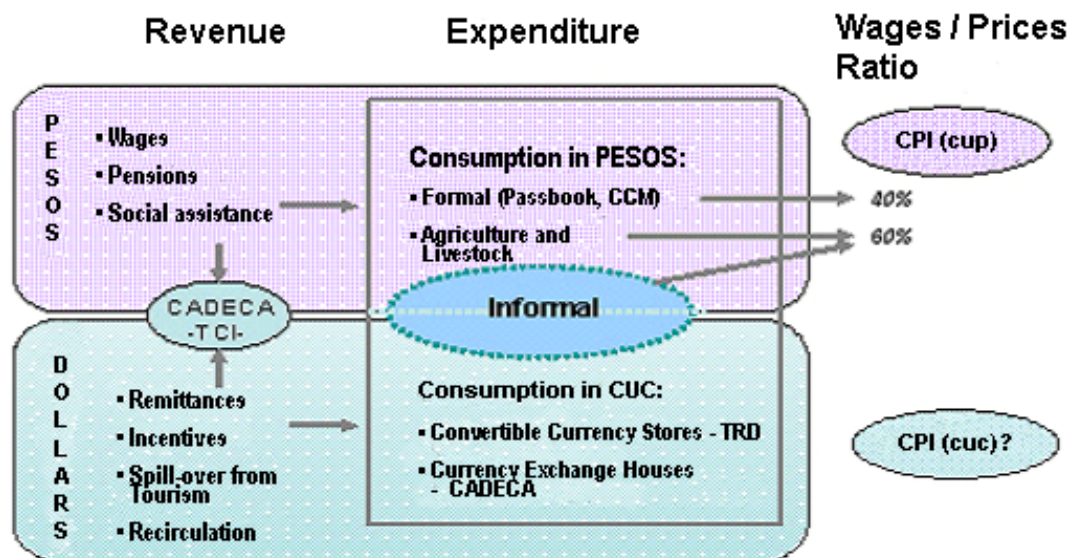
In general, this phenomenon is attributed to the existence of two currencies with operating areas that are pre-established institutionally (the market that uses Cuban pesos –CUP– the only one for which an inflation figure is provided, and the market that uses convertible Cuban pesos –CUC– which replaced the dollars that circulated until 2004) and has been seen as affecting mainly the people of Cuba.

In a synthetic way, this first division allows one to identify a facet of the monetary duality. Two currencies are used in the same territory, but each retains its own area where it circulates and mechanism for forming prices. The part that operates in Cuban pesos represents the bulk of people’s revenues and absorbs a large part of the state subsidies that pay for social services (education, health services, care of the elderly, etc) and in an overall sense it depends on the convertible-currency allotments that are the result of redistribution mechanisms. Meanwhile, the sector that operates in convertible currency (US and Canadian dollars, euros and convertible CUC pesos), better known as the emerging sector, features consumption and redistribution margins that are less restrictive.

²⁵ Speech by Raúl Castro on 24/II/2008 to the National Assembly and presentations to it on 28/XII/2007, by José L. Rodríguez, Minister of Planning and Economy, Osvaldo Martínez, Chairman of its Economic Commission, and Georgina Barreiro, Minister of Finances and Prices.

Graph 6. Segmentation of markets (revenue and expenditure)

Market Segmentation: Household Consumption



Source: Jorge Mario Sánchez Egozcue, *Internacional Seminar Migración y remesas en el Caribe: impactos y políticas*, Friedrich Ebert Foundation, Dominican Republic, 2005.

However, this first description does not capture the complexity of the network of incentives and distortions spawned by this structure. Although the structure is functional in the sense that it has a mechanism for channelling money that is in circulation towards the means of production, it is also a source of damaging dysfunction and inertia that make the whole monetary and trade system rigid when it comes to adapting to an international environment that is more and more volatile. Segmentation of the market is also associated with the existence of institutional regulations that inhibit more efficient coordination of markets in Cuba. This refers not only to the kind of currency used in them but also the rules under which those markets operate and which therefore influence the formation of the final price of products and incentives.

Table 4. Segmentation of markets: currency and regulation

	Kind of market	Kind of currency	State control	Influence of the CADECA exchange rate	Price formation	
Population	Rationed market	CUC	Total	None	Totally regulated	
	Agricultural markets: (suppliers)					
	- MINAGRI	CUP	Partial	Partial	Costs	
	- MINCIN	CUP/ Exchange rate	Partial	Total	Costs and fairness criteria	
	- EJT	CUP	Partial	Partial	Costs and fairness criteria	
	Foreign currency market			Total	Total	Totally regulated / international prices
	Black market	CUP and CUC		None	Total	Supply and demand
Business sector	100% state-owned Cuban companies (includes SA)	CUP and CUC	Total	Partial	Total control	
	Companies with foreign capital	CUC, euros, \$US	Partial	Total	Partially regulated	
	Branches	CUC, euros, \$US	Minimal	Total	Supply and demand	
	Cooperative businesses	CUC and CUP	Partial	Partial	Partially controlled	
	Self-employed sector (private)	CUC and CUP	Partial	Total	Supply and demand	

Source: the author.

This illustration of the segmentation of markets in Cuba is not complete, but it gives an idea of the complex environment in which companies, people and the State operate. These mechanisms were created as an interim measure in the early 1990s. However, after helping ease an initial liquidity squeeze, today they form a complex framework that affects both decision-making and allotment of resources on the basis of efficiency and therefore restricts productivity.

Judging by the latest comments from the government on this issue, all signs are that it is conscious of the absolute need to start modifying these conditions –there is talk of doing it gradually– in order to allow for greater consistency and rationality between the different markets and the process of planning.

Prices

Prices and the factors that influence their formation are also key when it comes to increasing productivity and efficiency and improving incentives.

Two factors are decisive: the exchange rate and wages.

One of Cuba's most pressing tasks is to find a single exchange rate that works for the whole economy and all goods and services. If the relative price of money does not work correctly, then it will be difficult for the rest of the prices to do so.

The main purpose of monetary policy in Cuba²⁶ has been to achieve stability in the CADECA exchange rate (currently 24 Cuban pesos to the dollar), given the relative weight that foreign currency consumption has in the living standards of the average Cuban. This is expressed not just in the proportion of family revenue that is spent in this segment of the market, but also in the variety and quality of products that are available exclusively in this market. Among the Cuban people, the main distortion is that while they pay for some goods and services in CUC or Cuban pesos (at the CADECA exchange rate) they get paid (and this applies to successive raises that have been verified) in Cuban pesos that have been devalued by inflation from 1990 until now.²⁷ This is the wage phenomenon which from 1990 to 2004 played a basic role in the restructuring of macro-equilibriums and the changes in the structure of spending and the always growing weight of the part of it that is done in CUC (or US\$ at the time). So the question is obvious: should the purpose of the current monetary policy change? Should the stability that has been achieved be sacrificed? Should the path to a single exchange rate be merged with the possible sacrifice of rate stability?

But it is in the business sector where monetary distortions exert their most pernicious effect. The existence of two exchange rates has made it necessary to keep two sets of accounting books, or even three if we take into account the 'single currency' in which, for all intents and purposes, Cuba operates with a one-to-one rate, and earnings in Cuban pesos and convertible pesos are added. This distorts both productive results and indicators of efficiency and makes it much hard to plan using firm foundations. So Cuban companies buy inputs (at least some of them) in convertible Cuban pesos at the going market rate and they 'buy work' (and pay) in Cuban pesos (in some cases such as the tourism sector at the rate of one to one, which is clearly over-valued, which reduces the profitability of this export sector). So, what is the real cost? What is the real level of efficiency and

²⁶ In recent years, many excellent studies have been done on Cuba's monetary problems, both in terms of analysis and regulations (most of them came from the Centre of Studies and the School of Economics at the University of Havana, and the Central Bank). Those worth mentioning include studies by Katia Cobarrubias (exchange rates), Anabel Cruz (remittances), Jorge M. Sánchez (inflation and stabilisation), Annia Fundora (prices and growth), Vilma Hidalgo, Yaima Doimeadios and Carlos Pérez-Soto (institutions and policies), Pavel Vidal (inflation, policies), Viviana Togores and Jorge M. Sánchez (remittances, territorial stratification and consumption). These and others show growing interest and a stimulating diversification of approaches, in contrast to the vacuum of previous years.

²⁷ The wage of 189 Cuban pesos –CUP– from 1989 is equivalent today in real terms to 46 pesos –CUP– for the same spending structure and markets in 1989 (P. Vidal Alejandro, 'La inflación y el salario real', IPS, year 20, nr 10).

productivity? How does one compare these results with those in other countries? What is the real competitiveness of Cuban products and services that can be traded? How can the government carry out truly efficient planning that helps raise productivity and allows for proper allotment of resources by the State. How can Cuba move toward fixing its wage problems *on a truly sustainable basis*?

The task of taking a closer look at how Cuban companies perform is one that has been repeatedly put off (even prior to 1990), regardless even of the kind of property: in this case, in an economy where state ownership of property dominates, to eliminate distortions that adulterate real contributions to social wealth or contribute to undeserved incentives magnifies the loss. In the same way, if the goal is to diversify the economic forces at play, elimination these distortions is an almost indispensable pre-condition.

The other side of the distortions has to do not with monetary but rather fiscal policy. Over the last 10 years, Cuba has managed a good fiscal record. It kept its deficit below 4% of GDP despite hefty outlays to pay for political decisions with a clear social component, such as free education and health care, reducing unemployment to a minimum, the opening up of sources of low-productivity jobs, generalised subsidies of products,²⁸ etc. Removing distortions in the monetary realm (using a single exchange rate) would force the government to redesign its fiscal policy, seek new sources of revenue and broaden its tax base as a way to guarantee the sustainability of the fiscal balance that is achieved.

2.4. Agriculture, Re-ordering of Management and Spending, and Partial Decentralisation

Cuba has a total surface area of 10,988,600 hectares (109,000 square kilometres), of which 6.6 million are considered farmland. Of these, as of late 2006, 3.1 million were reported officially as yielding crops, while 2.3 were pasture land and 1.7 million were recognised as idle.²⁹

The agricultural model applied in Cuba since the early 1960s gave priority to export crops (sugar cane, coffee and tobacco). One consequence of this model, which was applied for more than three decades, was the formation of a production structure that was not very flexible. More than 52% of the land that was farmed was earmarked for export crops, with sugar cane taking up 48.7%. And a major part of the land used for farming was dedicated to grazing land, which took up as much as 35% of the total. Four factors make agriculture a strategic sector for the Cuban economy:

- (1) Its share of revenue from exports of goods; of the things Cuba exports, three of them (cigars, sugar and citrus fruits), which depend directly on agriculture, are among the top five.
- (2) Food imports as a proportion of total imports (around 18%) and the country's dependency on food imports.
- (3) Its decisive role in what Cuban families spend; it is estimated that between 70% and 75% of the average Cuban family's spending goes to food.
- (4) Its importance as a provider of jobs.

The Cuban agriculture sector accounts for a small part of GDP but is of fundamental importance for the economy as a whole because of its direct impact on people's living standards and the health of government coffers: foodstuffs are Cuba's second-largest import. Agriculture also has an indirect role in GDP and a multiplying effect on the rest of the economy. The sector accounts for 20% of all

²⁸ Just as an example, if there were no subsidies for rice, which is a staple for Cubans, it would have to be sold in the rationing system, at more than 11 Cuban pesos per pound, which would more than 40 times the current price in that market. However, in the case of food, that price differential could serve as an incentive for producers (state, cooperative or private), with good prospects for improvement: for the State, by reducing the subsidy; for everyday people, through an increase in supply; and producers would get higher prices at the wholesale level. Cuba could use a system like the one it employs in the case of energy, or payment against import savings.

²⁹ ONE, *Anuario estadístico de Cuba*, 2006.

jobs in Cuba (970,700 out of 4,867,700), nearly double that of education (580,000 jobs), and is thus the second largest source of employment.

The sector was well-funded in terms of technology and energy prior to 1990, but its output and productivity were still low in general compared to the world average, with the exception of the potato and tomato crops.

As of the end of 2007, the sector contributed only 3.8% in the direct generation of Gross Domestic Product. Before the significant drop in agricultural production, the sector accounted for approximately 7%-8%.

The farm sector played an important role in the economic changes that began in the 1990s. In fact, an important part of the process of de-centralisation and expansion of market relations took place there. The two most important events were these:

- (1) Creation of Basic Cooperative Production Units (UBPC in Spanish).
- (2) The reopening of agricultural markets.

Production figures from 2000 to 2007 showed it was essential to undertake radical reforms. The average yearly growth rate during this period did not surpass 0.9%.

The government took four main measures to transform the sector:

- (1) Decentralisation of decision-making, shifting it to the municipal and local levels. This has also meant decentralization of allotment of resources and direct purchasing of inputs and equipment.
- (2) Modifications in the systems of setting prices for producers (this has already started with products like milk and potatoes).
- (3) A drastic cut in commitments for sales to the state-owned firm Acopio, and recognition of the right to surplus production on the market at the price established by the process of supply and demand.
- (4) Allowing an increase in the amount of land worked by peasants, through usufruct of idle land owned by state companies.

Recovery of the farm sector must be seen as part of a broader reform process. In the reform process that took place in the early 1990s and today, it was the sector itself which got things going. This is due to its effect on people's lives through food prices, and the trade balance by replacing imports. However, the undercapitalisation that the sector is suffering, along with migration of farm workers to other jobs, make one think that an essential component of this recovery should be the modernization and recapitalization of the Cuban farm sector. This requires a hefty investment of capital which the State probably cannot provide in its entirety. One can therefore infer that the government might follow through on its announcement of a few months ago that it is interested in making room for foreign investment.

3. Interactions Associated with Change

3.1. Traditional Tourism Declines, and Exports of Health Services Rise: Shifting from Revenue from Sugar to Revenue from Doctors; A Repetition of the 80s?

Unlike the years prior to 2004, today health care services are Cuba's top export, accounting for around 50% of all export revenue (goods and services). Although this outsourcing has been a success in terms of revenue, it has also prompted much debate, with varying opinions. Some question whether it is sustainable because the exports are done under politically-motivated agreements between governments. Others complain it has little impact on the Cuban economy

through backward or forward ripple effects. Still others say this export could become a new pivotal sector of the economy by providing revenue that can be used to jump-start other productive sectors. There is agreement, however, that Cuba must not repeat the historic error of making its economy depend on just one sector and just one country.

One area of analysis is Cuba's burgeoning health-care sector and its overseas projection. Today more than 25,000 doctors work in a variety of other countries, but most are in Venezuela, along with hundreds of health technicians, nurses and support staff. Besides medical services, Cuba also exports medical equipment and generic and biotechnological medicines. If we consider all this, in addition to the investments Cuba has made in the biotechnology sector and its business deals in technology transfers, then we are talking about one of the most dynamic sectors of the Cuban economy. It also has great potential for generating synergies that might amplify its effect on the rest of the economy in the near future.

Tourism, meanwhile, provides Cuba with a fourth of its export revenue, purchases from the national economy more than 68% of what it consumes, provides 100,000 jobs directly and a similar number indirectly, generating backward ripple effects that stimulate the Cuban manufacturing sector.

However, arrivals of tourists are down and this may be due to insufficient marketing and a lack of promotion, an increase in marketing in the region and overvaluation of the convertible Cuban peso. Added to this are a deterioration in the quality of services and infrastructure in the tourism sector, which have been hit by a decrease in investment (tourism construction was 25% of what it was in 2005).³⁰ This could be another factor in the sector's disappointing performance.

However, arrivals were up 15% in the first three months of 2008 and this might signal a reversal of the negative trend of the past three years.

One of the challenges that Cuba faces is to define a strategic development plan. Its implications for employment and infrastructure are important. Should Cuba renounce an engine of growth such as tourism, which, as far back as the 1950s was practically the second most important sector of the economy and in the 1990s showed it could compete successfully in the region, even though Cuba had no access to the US market, and had the ability to stimulate production else in the economy?

The answer is that, although it is good idea to strengthen the tourism sector because of the benefits one can expect from it, the problem is one of defining its scope. The main competitive advantages that the Cuban economy enjoys these over its regional competitors do not stem from its climate, natural resources or Geographic location with respect to trade flows. Rather, Cuba's edge comes from accumulated investment of millions of dollars over the course of decades in manpower. Cuba now boasts a large number of professionals in a variety of fields (not just health care), ranging from computer sciences, biotechnology, application of advanced techniques in agriculture and other areas of innovation. And the performance level of these people is still below their potential. The following table examines other strengths and weaknesses of the Cuban economy compared to those of other countries in the Caribbean region.

³⁰ ONE, *Panorama económico y social 2006*, www.one.cu.

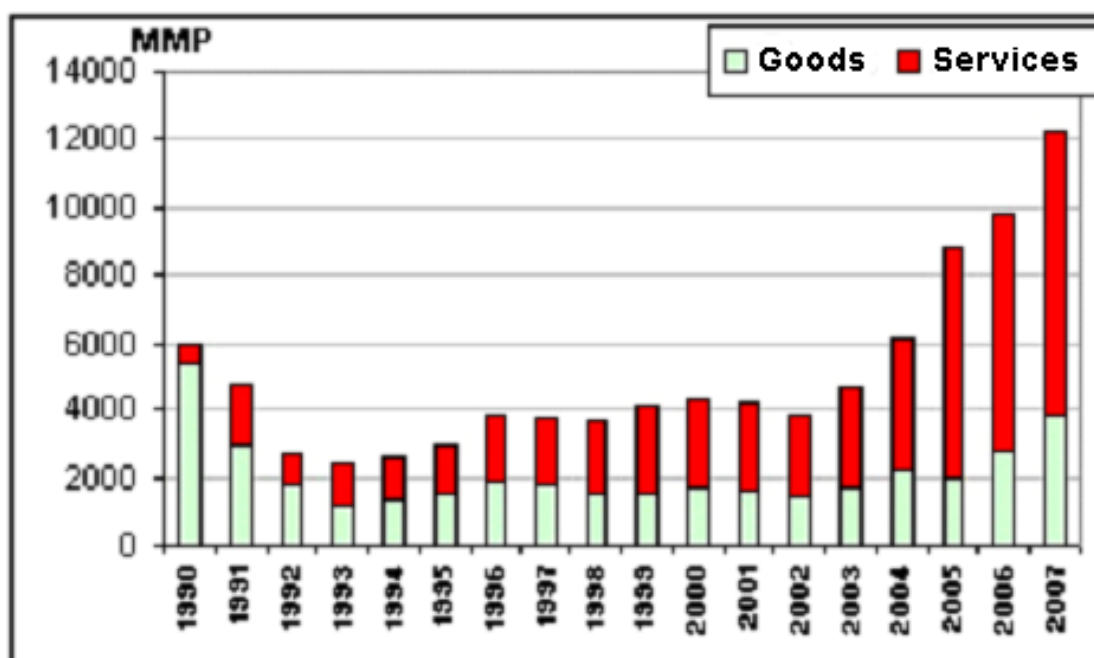
Table 5. Cuba: relative sources of competitive advantage compared to Caricom standards

Source	'value'
Availability/cost of capital	insufficient
Government regulation	strong
Qualifications of workforce	strong
Macroeconomic/fiscal policy	moderate
Marketing	insufficient
Product design/quality	weak
Productivity	weak
Quality of administration/control	insufficient
Natural resources	strong
Tax structure (tariffs/other, non-tariff barriers to trade)	weak
Technology (industrial base)	moderate
Transport infrastructure	strong
Wages	wéakl

Source: Jorge Mario Sánchez-Egozcue, 2004.³¹ Caricom standards taken as reference levels. The scale was devised with the following 'values': the term *strong* means the value surpasses the regional average, *moderate* means it equals the regional average, *weak* means below the regional average and *insufficient* means it does not reach a minimum compatible level.

However, all this said, Cuba's export revenue structure clearly confirms the dominant position of its services sector. Tourism and exports of health services make up the lion's share of these revenues.

Graph 7. Evolution of breakdown between goods and services in exports



Source: data from the *Anuario estadístico de Cuba*, ONE.

3.2. Adjustments in the Foundations of Cuba's Place in the International Economy, a Shift Towards China and Venezuela

One aspect of recent changes in Cuba is that not only has there been a geographical shift in the areas of economic and financial activity, but also in the nature of the accords that sustain it.

In the 1990s, the EU and Canada were the main sources of new trade and investment that replaced the old communist bloc. Tourism, new investments in infrastructure (transport, airports, telecommunications, etc), mining and new industries (energy, a variety of manufactured goods, electronics) allowed Cuba to expand and renew its productive base. All of this was achieved through arrangements centred on mainly on prices and the conditions of the international market.

³¹ Jorge Mario Sánchez Egozcue, 'Challenges of Cuba's Insertion in Caribbean-US Trade', in Jorge I. Domínguez, Omar E. Pérez & Lorena Barbería (Eds.), *The Cuban Economy at the Start of the Twenty-First Century*, The David Rockefeller Center Series on Latin American Studies, Harvard University Press.

So one can say that in this period Cuba's reincorporation into the international economy was done with competitiveness and normal prices as criteria. However, once Cuba started looking to China and Venezuela as its main sources of financing, this factor was largely replaced by a different negotiating framework. Today, the foundations of Cuba's rejoining the international economy are agreements between its government and other governments.

The main advantage of these accords is that they provided Cuba with greater stability over the medium term. These links were protected from the constant threat of a strengthening of US sanctions (as occurred with transactions carried out in dollars, the clearest case of which were the sanctions imposed by the Treasury Department's Office of Foreign Assets Control against the Swiss bank USB for accepting deposits in dollars from the Cuban government). But in the case of Venezuela, the downside to these agreements is that they concentrate risk in another way. They could conceivably lead to excessive dependence on arrangements established under special conditions that might undergo substantial changes if domestic political conditions vary.

The net result of the post-2004 shift is that both Canada and the EU lost relative weight in their trade and financial ties with Cuba. This was not because of a change in their performance or established strategies. Rather, it was due to the aggressive positioning of China and Venezuela through mutual government support and Cuba's stated desire to boost prospects of integration that are not subject to the uncertainties of the International market.

Over the medium term, Chinese investment will have a major impact through a boost in Cuba's revenues from exports of nickel, recovery of its transport system and new capacity for oil refining. Meanwhile, Venezuela accounts for nearly two-thirds of the revenue Cuba takes in through exports of health care services and also sells Cuba fuel at a discounted rate. Then there is also the potential trickle-down effect of Cuba's being integrated in major projects involving trade, investment and cooperation with other Latin American countries, although for now more political energy has been invested in the signing of agreements than in the actual implementation of such deals over the short term.

In 2004, Cuba and Venezuela signed an accord under which the former would provide health care services in exchange for oil, and almost simultaneously China granted Cuba a new line of credit for investment. Just over three years later, these two countries account for a third of Cuba's international purchases, to the tune of more than US\$2.2 billion and US\$1.57 billion in the last year, respectively. These transactions are at the root of lion's share of the rice in recent debt.³² The last report issued by the Cuba-Venezuela Intergovernmental Commission said in February 2007 that these links had deepened with the signing of 350 bilateral projects worth US\$1.5 billion.

Bilateral trade with China totalled US\$1.79 billion last year, up 105.4% from 2005. Meanwhile, in January 2006, Cuban trade with Venezuela totalled US\$2.6 billion (almost double the US\$1.4 billion figure from 2004). This means that these days the two countries account for 35% of Cuba's trade.³³

4. Economic Relations with the European Union

After the fall of communism, the EU gradually took on more importance as part of the process of Cuba's re-directing its trade and financial ties. Of the countries of eastern Europe, Russia and Ukraine are the ones which, after a relatively long pause, have tried to recover some of the presence they once held in the Cuban market.

³² 'Supera los 15 mil mdd la deuda externa de Cuba, al cierre de 2006', *La Jornada*, 31/VII/2007.

³³ Marc Frank, 'Cuba's Trade Booms with China and Venezuela', *Reuters*, 27/II/2007.

The EU was Cuba's top trading partner in the 1990s. From 1993 to 2004 it provided more than €147 million in assistance, and it has an office in Havana to administer those programs. Despite relatively scant support at the official level, trade, investments and tourism grew during this period without major setbacks.

EU economic assistance was initially provided as 'humanitarian aid' for a country that was admittedly going through an economic crisis. But in the mid-1990s this changed to a more lax focus on 'economic cooperation'. This suggested a shift in perception of short-term assistance toward programmes that supported the reforms under way at the time. It was understood that there was political stability and that the process of economic recovery was only possible if it was supplemented with outside resources.³⁴

In general, so far most of Cuba's ties with countries of the EU have been established through bilateral arrangements and they depend on three factors: (1) the attitude of the US, which has insisted on promoting a policy of bringing other countries over to its position toward the island by having them endorse the trade embargo; (2) the low relative weight of economic interests (although there are good prospects for development in areas such as tourism and investment, Cuba is not a particularly sensitive market for the EU); and (3) the perceptions of the European Commission and the European Parliament on the domestic political situation in Cuba. This is reflected in the climate of support for or discouragement of the strengthening of said economic ties.³⁵

For the most part, economic relations between Cuba and the EU can be characterised as a mix of limited cooperation, exchanges through bilateral arrangements with not much government support, and political disagreements (which took shape in the sanctions imposed in 2003, which the Cuban government calls unacceptable), which prevent a broadening and deepening of ties.

At the beginning of 2000, the EU was Cuba's top financial and trade partner, and its second largest source of tourism. Trade in goods with Europe accounted for around 43% of Cuba's total, while the average for the period 1990-2001 was 26.6% (putting it in second place). European imports represented a little over 31%, with Spain, Italy and France among the top partners, with 40% of Cuban exports heading to that area.

Another area in which the EU has taken on a significant presence is foreign direct investment. As of 2007 there were 232 AEIs (*Asociaciones Económicas Internacionales* or International Economic Partnerships), 41 of them concentrated in basic industry and tourism. By countries, Spain and Canada accounted for 50% of them, followed by Italy, although there are also arrangements called *Producciones Cooperadas*, or Cooperative Production, in which Spain and Italy represent 47%, and 74 *Contratos de Administración* (Administration Contracts), almost all of which are concentrated in the tourism sector.

The main opportunities for these ties are in construction, tourism, basic industry and agriculture, mainly projects designed to replace imports.

It is also important to consider some recommendations made a few years ago to offset the effects of the Helms-Burton Law passed in the US, which continue to take their toll and illustrate areas Cuba might focus on: seek mechanisms to accelerate negotiations on Cuba's foreign debt, promote programs to encourage European companies to invest in Cuba, and increase the availability of credits for exports by European firms that feel a lack of insurance or its high cost are a major obstacle to expanding their sales.³⁶

³⁴ IRELA, 'Cuba y la Unión Europea, las dificultades del diálogo', 1996, <http://www.irela.org>, p. 6.

³⁵ Jorge Mario Sánchez Egozcue, 'Redefining Cuba's International Economic Interests', in Michael Erisman & John Kirk (Eds.), *Redefining Cuban Foreign Policy: The Impact of the Special Period*, University of Florida Press, 2006.

³⁶ Gareth Jenkins, 'Implications for Trade and Investment of the Cuban Liberty and Democratic Solidarity Act 1996

Another factor that cannot be ignored is that many of Cuba's export goods are also exported by its regional neighbours and this poses a challenge: even if Cuba were to resolve political and institutional issues, this is not guarantee there would not be other obstacles to overcome. For now, if political tensions with the EU ease, Cuba's main task would be to grant more flexibility to and broaden financial coverage and insurance for trade transactions.

In June, the EU plans to review its policy toward Cuba. In preparation for this, Louis Michel, the EU Commissioner for Development and Humanitarian aid, recently visited the island to hold talks with the government. Afterwards, he said there is a new about Cuba that brings change with it, and the EU should reach out to the Cuban people at this time. The Netherlands and Spain are considered the countries most in favour of reviewing the sanctions, while the Czech Republic wants to keep them in place. 'These sanctions have not worked, neither the European ones nor the US ones', said Maxime Verhagen,³⁷ the Dutch Foreign Minister. Her remarks show that the main problem with the EU refers not only to the difficulty of finding a consensus among opposing opinions but also the fact that even within an agreed position, when it comes to implementing it there may be varying interpretations of how to go about this.

However, even with a lifting of the sanctions and a will to support economic relations (either at the bilateral or EU level) it would be difficult for there to be drastic changes in the current process of Cuba joining the international economy. At least over the short term, it is unlikely that European countries will recover the top spots they occupied in the 1990s as trading partners with Cuba.

5. The US Factor in Cuba's Performance in the 1990s and the Prospects for the Future

5.1. Trade in Goods (Foodstuffs and Agricultural Products)

Starting in the late 1980s, changes took place in trade between Cuba and the US, in which foreign-based units of American companies sold Cuba medicine, equipment and food. It was not until the early 1990s that the fall of communism gave an extra boost to these exchanges, which increased significantly as traditional suppliers were replaced. The figure surpassed US\$700 million. But this burgeoning flow was choked off in a relatively short span of time with the approval of the Torricelli Law in 1992. The idea behind the bill was that, if the Cuban government were denied this new outlet, it would soon face economic collapse in a sort of 'domino effect' associated with Cuba's failure to incorporate itself in the international economy over the short term.

Compared to the previous decades of reciprocal isolation, in which there was no trade between Cuba and the US, the achievements of the 1990s served to confirm that there was potential waiting to be tapped. This gave the US business sector incentives to keep seeking operating room within the restrictions that were in force. This was reflected in growing activism that facilitated the steps taken later.

Before 2001, the issue of trade between the US and Cuba was seen mainly as one for academic speculation rather than a short-term, imminent reality for businessmen.³⁸ Even the most optimistic entrepreneurs were more inclined to look for other business opportunities in the region rather than invest time, money and energy in something that looked so uncertain. This perception changed drastically toward the end of 2001, when the terms of the impasse took a turn for the better after

(Helms-Burton)', *Cuba Business*, July 1996, p. 8.

³⁷ Pablo Gámez, 'Cambiará la política europea sobre Cuba?', Radio Netherland, 18/IV/2008.

³⁸ The section on Cuba and the US is an abridged version of a paper by Jorge Mario Sánchez-Egozcue, 'Economic Relations Cuba-US, Bilateralism or Geopolitics?', presented at the Congress of the Latin American Studies Association (LASA), Montreal, 6-8/IX/2007.

Hurricane Michelle struck Cuba, causing more than US\$1.87 billion in damage. The US government offered humanitarian aid, but Cuba rejected it on grounds that it came with strings attached. As an alternative, it was suggested the Treasury Department set up a fast-track arrangement to grant licences under which Cuba could purchase foodstuffs. Thus it came about that in December 2001 the first purchases were made, to the tune of US\$35 million. In September of the following year, Havana hosted the first US-Cuba Agricultural Trade Show. In attendance were 750 representatives of 288 companies from 33 states, and contracts worth US\$112 million were signed.³⁹

In just three years the US went on to become Cuba's main supplier of farm goods, totalling US\$392 million, or 42% of all of Cuba's agricultural imports. The rapid growth of this trade can be seen in Table 6.

Table 6. Cuban imports of foodstuffs from the US (value of purchases in US\$), 2007

Year	Value (US\$)
2001	4,433,654.28
2002	175,858,590.81
2003	343,947,276.14
2004	474,113,308.38
2005	540,897,493.99
2006	570,829,431.13
2007	71,015,938.75

Table 7. Trade agreements signed by the Cuban government and US delegations (through 2007)

Dept of Agriculture of Alabama	Port of Manatee, Florida
Dept of Agriculture of Iowa	Port of New Orleans, Louisiana
Dept of Agriculture of Michigan	Port of Philadelphia, Pennsylvania
Dept of Agriculture of North Dakota	State and Department of Agriculture of Maine
Dept of Agriculture of Pennsylvania	State and Dept of Agriculture of South Carolina
Dept of Agriculture of Virginia	State and Dept of Agriculture of Vermont
Homedale Farms, Minnesota	State of California.
Indiana Farm Bureau	State of Idaho
Iowa Corn Growers Association	State of Kansas
Mobile Port Authority, Alabama	State of Louisiana
Montana Farm Bureau	State of Nebraska
Port of Corpus Christi, Texas	US Grain Council
Port of Houston, Texas	US Rice Federation
Port of Lake Charles, Louisiana	US Rice Producers Association
Port of Manatee, Florida	US Soybean Association
Port of Lake Charles, Louisiana	US Wheat Associates

To date, under the *Trade Sanctions Reform and Export Enhancement Act (TSRA)* of 2000, more than 4,350 companies and 132 farm associations and federations have visited Cuba to explore what its market holds. From 2001 to 2006, contracts were signed with 159 companies from 35 states. The deals covered more than 300 foodstuff or farm produce. A total of 23 ports were involved in these transactions. This made Cuba the 25th most important market in absolute terms for US exports of these products.⁴⁰ The contracts were worth US\$2.28 billion (equivalent to 8.3 million tons of goods). As of the time this report was written, nearly 100% of the contracts had been carried out.

One must also note that one of the reasons behind this huge increase in sales is a deterioration of Cuban efficiency in food production, for a variety of causes. So one should not view this development as stemming only from processes of new trade flows, or substitution of markets, as it is also called, as a result of lower transport and insurance costs linked to the geographical proximity of the two countries, or from price factors.

³⁹ These figures and the subsequent ones in this section come from MINAL, *Alimport Cuba, 2007*, and from the Special Report, 'US Agricultural Sales to Cuba: Certain Economic Effects of US Restrictions', Investigation nr 332-489, Publication 3932, United States International Trade Commission (USITC), July 2007.

⁴⁰ By key products, Cuba is the third-largest market for rice (USA Rice Federation), the eighth largest for chicken (USAPEEC) and the 12th largest for wheat (US Wheat Association).

Reducing Food Vulnerability

In 2005 and 2006 this boom eased because of a variety of factors, but mainly due to the toughening of US measures after George W. Bush won a second term as president in 2004. The result was a new series of regulations by the Office of Foreign Assets Control of the Treasury Department, requiring that food shipments be paid for in advance before ships carrying the cargo could leave US ports. The immediate consequence was a decline in Cuba's ability to pay, forcing it to make purchases from other, more distant markets at a higher cost. Added to this was a drop in remittances sent to Cuba, which affected the availability of foreign currency in Cuba. But another factor that influenced this process were new and better credit terms offered by competitors such as Vietnam, China, Canada and France. They offered Cuba short- and mid-term credits, which American exporters were barred from doing.

The contraction caused by this change in access to the US market served to highlight a factor that had not been considered before: vulnerability stemming from excessive dependence on food supplies from the US in a climate of political tension. Cuba thus embraced the concept of *food security* and set a maximum quota for imports of US food: no more than 50% of its total imports.

At the same time, one must consider other, non-economic factors affecting these trade flows, aside from the traditional ones of competitiveness in price, quality and shipping terms. These include tensions for the Cuban state agency tasked with carrying out such transactions, which is known as Alimport. It must diversify Cuba's supplies and boost geopolitical ties with an eye to the country's strategic interests. It must also gear purchase contracts toward US congressional districts or states in which local interests can be strengthened so as to pressure the US government into normalising relations with Cuba.⁴¹

The President of Alimport, Pedro Álvarez, has said that the ban on obtaining financing from private and government sources in the US also hurts Cuba by causing it to be classified as a 'risk country'. This raised the financial cost of transactions by at least 5%, which represents an additional increase in costs estimated at US\$21.8 million in 2006.⁴²

Another issue involves traditional suppliers of Cuba. Because of the practice of immobilising funds for purchases of American goods for 10-15 days before they are received, these suppliers say, this makes them face restrictive terms for payment that raises the cost of these operations. Another factor is the cost of financial transactions. Cuban banks incur losses of about US\$30 million by having to pay through banks in other countries in currencies other than the dollar. Finally, there is insecurity in delivery of goods because of delays in payments. In 2004, this amounted to an expenditure of US\$300 million in consumer goods for rationed distribution that were bought in far-away places at higher prices and higher costs for transport and insurance, due to insecurity in operations in the US market.

Compared with potential trade identified in a variety of studies, the current figures are still far from those projections. However, the most salient point is this paradox: the highest ever trade level between the two countries since the Cuban revolution was achieved precisely at the time when US sanctions were at their toughest.

There is no doubt that new factors have emerged from this evolution in bilateral trade relations between Cuba and the US: (1) the appearance of a force like the business sector, which went from having an attitude of indifference or waiting for a scenario of a change in government, to a growing zeal to gain access to the Cuban market without making this conditional on political change; (2) the growing trade that started in 2004 has had related effects that were not there before and could be

⁴¹ International Trade Commission, *Recent Trends in US-Cuba Agricultural Trade*, USITC, 2007.

⁴² María Julia Mayoral, 'Pierden empresarios de EEUU oportunidades de negocios en Cuba', *Granma*, 6/1/2007.

relevant for the future; (3) even if trade relations were normalized without severe complications, for Cuba it would be a major challenge to consider the adjustments this process might cause in its trade and economic partnerships. There would be a trade-off between stability and risk diversification, on one hand, and the benefits of having access to the market closest to it geographically, with lower costs and high levels of quality, but also associated with a high level of political sensitivity that could wipe out all those benefits.

5.2. Tourism Forecasts

The Cuban Tourism Minister Óscar González has estimated that 1 million US tourists might visit the island in the first year if the trade embargo were lifted.⁴³ Similar figures have been reported in other studies, with some variations as to the timeframe, placing it between one and three years, and number of visitors, ranging from one to four million. The lower-range figures come from the US-Cuba Trade Association and the American Society of Travel Agents (ASTA).

In 2004 Cuba received just over 209,000 visitors from the US, making this country its eighth-largest outbound market with a market share of more than 10%. Of the 2.2 million tourists who visited Cuba in 2006, an estimated 8.8% of them were Americans, and in 2007 the figure was 10.6%, approximately half of the number for prior to 2000. The drop was due to the toughening of restrictions on travel permits by the OFAC starting in 2004.

Table 8. Cuba: visitors from the US

Year	Americans	Cuban-Americans
1995	20,672	–
1999	62,345	–
2000	76,898	–
2001	78,789	–
2002	77,646	–
2003	84,529	125,279
2004	49,856	148,151
2005	37,233	157,873
2006	36,808	192,713
2007	nd	197,000

Source: José L. Perelló, 'El escenario turístico cubano, polarización de una tendencia', Center for Tourism Studies, presentation at VIII Canadian Studies Seminar, 2008.

One also assumes that the increase in lodging capacity and improvement in hotel services that Cuba has posted over the past decade have allowed it to handle the growing demands of US tourists over the short term. However, this is still below its potential of a million visitors, because the ones who have come so far represent just 20% of that total. At the same time this market is an area of special attention. Certain changes in infrastructure and services are needed to cater to the idiosyncrasies and expectations of quality of this segment of the market, mainly in light of the competition that Cuba faces from its neighbours. But in general terms it is agreed that Cuba's moderate hotel occupancy rate (around 60%-70%), and seasonal differences with respect to its main outbound markets (Canada and Europe), which prefer to travel to Cuba in winter, give Cuba leeway over the short term to handle the current demand.

According to estimates by the US International Trade Commission, if travel restrictions were eliminated there would be a flow of at least 171,000 visitors over the short term and this could go up to 554,000 or even 1.1 million tourists. The figure could go up by 226,000 to 358,000 visitors per year. All this would mean an increase in Cuban revenues of between 13% and 33%.⁴⁴ Another effect of this increase in US tourism is linked to the increase in Cuban demand for imports of US products and farm goods. This would stem from an increase in revenue for this purpose.

⁴³ 'Cuba Not Ready, But Expecting US Tourists', Reuters, 2007.

⁴⁴ USITC, *op. cit.*, 2007, p. 3-14 & 3-17.

Despite these projections, the figures for arrivals of Cuban-Americans are inaccurate because many of them arrive in Cuba from third countries. The following are estimates for the United States.

Table 9. US tourism bound for Cuba (thousands of visitors), 2000-05

	2000	2001	2002	2003	2004	2005
World	1,174	1,175	1,686	1,906	2,049	2,319
US	200	204	219	236	163	171

Source: USITC.

Today Cuba faces several challenges in its tourism industry, some of them of a domestic nature. They include environmental protection, cultural impact, developing service infrastructure, greater integration with agriculture and domestic industries, achieving greater flexibility in domestic financial mechanisms linked to aviation, and changes in convertibility margins. All of these factors, along with fierce competition in the region, had been eating away at Cuba's initial advantages.

However, for Cuba the biggest transformation has been a shift from traditional tourism to health-related tourism. This change has also been the basis of a deeper structural transformation in all of the country's foreign trade. It has seen a massive shift toward exports of health care services, so much so that approximately 70% of current revenues come from this source. The change has relegated tourism from first to third place as a revenue source in a relatively short span of time.

Keeping in mind all the factors described above, we must insist on the importance of evaluating carefully the probable impact of a huge boom in US Tourism. This analysis must address not only the positive side –revenues, improvements in infrastructure and the 'wave' effect on other sectors of the Cuban economy– but also take a broader approach. Here, the idea is for Cuba to take advantage of all these opportunities but do so in a way that gives priority to Cuba's real advantages in other sectors rich in human capital, such as manufacturing and knowledge-based services (medicine, software, biotechnology, etc). These not only have a greater impact in terms of added value, but also have a significant multiplying effect in creating jobs and rippling through the rest of the economy.

For these reasons US tourism should not be seen as an end in and of itself. It must be linked to prospects for integration; in other words, it must part of Cuba's long-term drive for development, not something considered separately. This is of particular importance for Cuba, whose export profile is very similar to that of its Caribbean neighbours in terms of primary products and services. At the same time Cuba must accentuate those things that give it a competitive advantage, especially with regard to workplace skills and advanced technology.

In summary, the prospect of US tourism flows if Washington were to allow them certainly represents a major opportunity over the short term for Cuba to expand services and project these benefits onto other areas of the economy (transport, communications, construction, agriculture, the leisure industry, etc). But from a broader perspective, this tourism does not necessarily have to take top priority for Cuba.

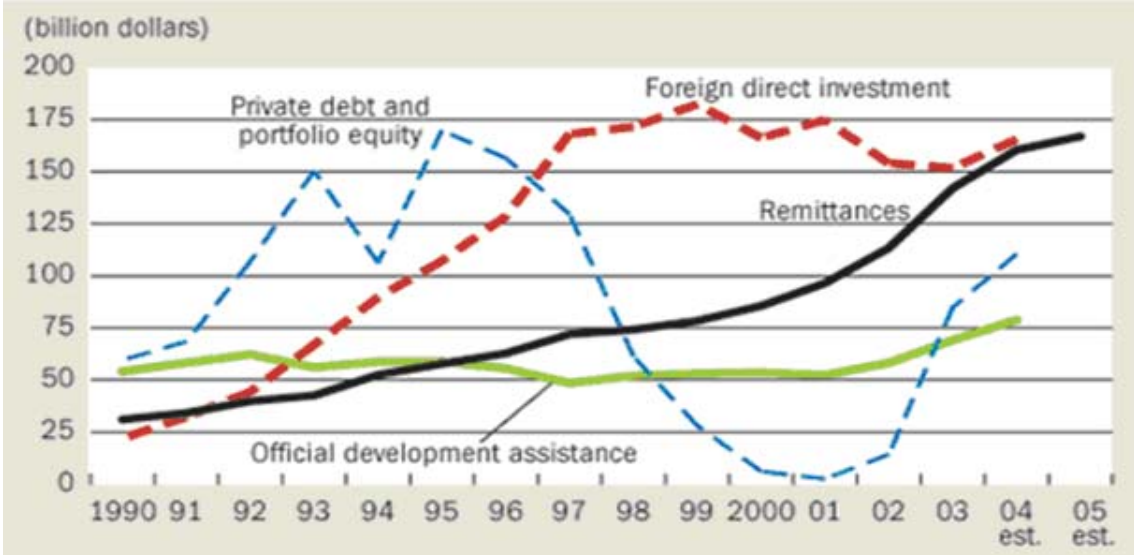
5.3. Sending Remittances

Remittances have become the third pillar of economic relations between the US and Cuba since the 1990s. Prior to the current euphoria that surrounds these growing shipments of money from developed nations to countries that are sources of emigrants, the macroeconomic and social effects of remittances had been downplayed. This was due in part to the fact that they involved simple and highly fragmented circuits, and because there was no trustworthy and standardised method to record them. These limitations have been acknowledged, and now there is a re-emergence of analytical literature that questions many of the previous myths surrounding remittances. These studies propose new interpretations of the impact of this kind of money, not just in terms of consumption but also

macroeconomic policy and what it means for having countries joint international financial circuits. The phenomenon has seen much activism by the Inter-American Development Bank, the International Monetary Fund and the World Bank, all of which have carried out studies of this issue.

More attention is being focused on remittances because they have grown so much in importance they have overtaken development aid and in some cases even foreign direct investment in developing countries, becoming their second largest source of financing, as seen in the following IDB graph.

Graph 8. Remittances, second source of revenue in Latin America



Source: Inter-American Development Bank, Multilateral Investment Fund, *Sending Money Home, Leveraging the Development Impact of Remittances*, Washington DC, 2006.

Cuba has not stayed on the sidelines of this trend; more than a million Cuban emigrants live in the US, even though its institutional and economic structure is different from that of its Caribbean and Central American neighbours. The island has adopted many of the features common to nation that receive remittances in terms of volume of money sent, the frequency of the shipments and their general uses. However, as we shall see, there is political and economic sensitivity that makes Cuba stand out.

In the case of Cuba, there have been relatively few studies (at least publicly available ones) to address some aspects of this phenomenon, such as how Cuba compares with other countries in the regional context, the evolution of political actions that the Cuban and US governments have taken to either encourage or restrict remittances, changes in social and international relations between emigrants and Cuban society, their impact on social differentiation and levels of household consumption, and overall effects and features.

Other aspects require further study, but for the purposes of this study we will provide only a general characterisation of remittances sent to Cuba and discuss their multiplying effects in the Cuban economy as a result of their specific features such as segmented markets, monetary duality and mechanism for assigning financing for business activity. These channels are decisive in shaping the impact of remittances sent to Cuba.

Estimates of remittance flows to Cuba vary depending on the source and on the methods and assumptions applied: the range is US\$700 million to US\$1 billion per year, of which almost all of it comes from the US. The closest proxy indicator is that of net transfers reported in the balance of payments. Remittances are considered to represent on average 90% of these. The problem with

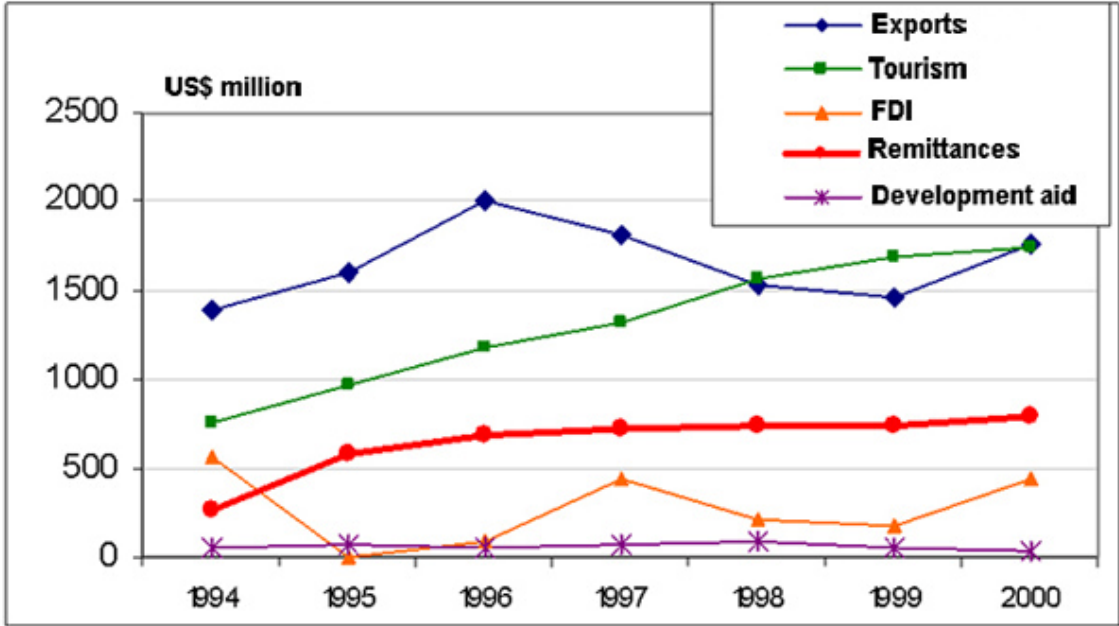
making the calculation is that remittances get mixed up with other sources of convertible money that enter the economy, such as ‘spillage’ from tourism, money that performers and another professionals bring back after fulfilling contracts abroad, complementary payments that the government makes in convertible currency and other transactions affecting domestic recirculation of money.

Table 10. Remittances sent to Cuba, estimates by different sources (in million of dollars)

Year	ECLAC	ONE	EIU	WDI	Barberia
1994	470.0	470.2	450.0	309.9	262.8
1995	646.0	646.2	552.0	646.2	582.6
1996	744.0	743.7	597.0	743.7	686.5
1997	792.0	791.7	688.0	179.7	726.4
1998	813.0	813.0	770.0	813.0	732.9
1999	799.0	798.9	858.0	798.9	740.4
2000	740.0	740.4	–	842.4	798.4
2001	813.0	812.9	–	–	759.4
2002	820.0	820.0	–	–	758.9
2003	915.0	915.0	–	–	–
2004	1100.0	1100.0	–	–	–

Sources: CEPAL and Cuban reports on net current transfers (of which remittances are estimated to represent approximately 90%); CEPAL (1997, 2004-05); ONE, Statistical Yearbook of Cuba (1999-2005), ONE, Cuba in Figures 1998, Report from the Central Bank (1990-94), The Economist Intelligence Unit (EIU), Country Risk Service 2nd Quarter 1998, April 1998, Country Report (2003-04, November 2002), (2004-05, May 2004), (2005-06, September 2005, November 2004), World Development Indicators (WDI) 1960-2000; Lorena Barberia (2004). Calculated as the difference between net transfers and official development aid, Table 10.2, p. 368.

Graph 9. Remittances, third largest source of revenue in the 1990s

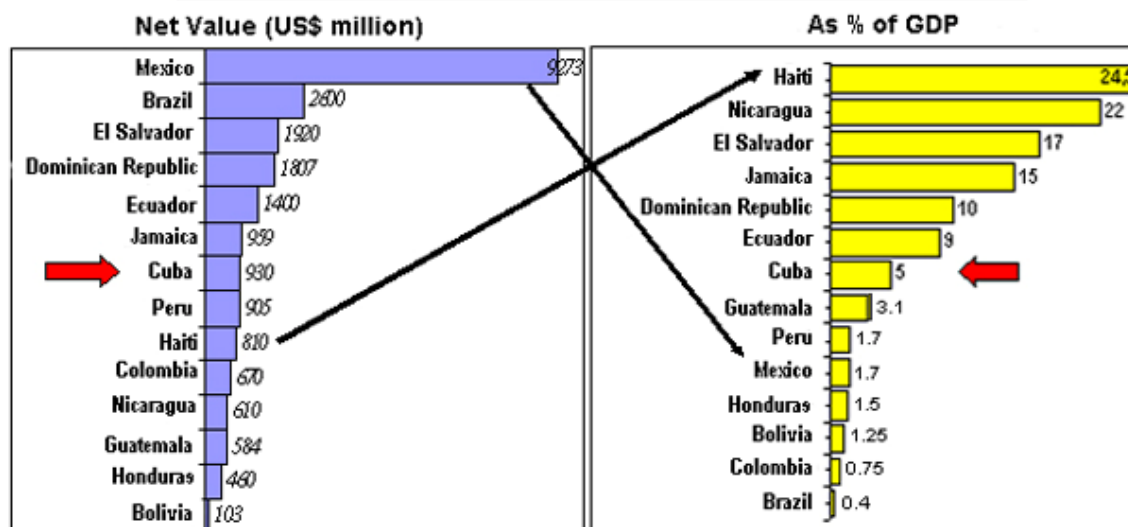


Sources: Lorena Barberia, ‘Remittances to Cuba: An Evaluation of Cuban and US Government Policy Measures’, in Jorge I. Domínguez, O. Everleny & Lorena Barberia (Eds.), *The Cuban Economy at the Start of the Twenty-First Century*, Harvard University Press, 2004, table2, p. 46. FDI data taken from ECLAC (1997, 2001, 2003). Data on other indicators come from World Development Indicators (2003).

In Cuba, remittances have a dual nature. On one hand they act as revenue that expands the reserves of the Central Bank and thus Cuba’s ability to make payments abroad. But domestically they have the important effect of providing more financing for businesses. Once dollars come into Cuba and reach the Central Bank, they can be transformed into loans for retail businesses. However, the main impact of remittances stems from Cuba’s having dual markets and currencies. Remittances tend to be source of stability that protects against distortions in prices which exert pressure on wages, and against social polarisation not linked to wages. This polarisation creates a mentality of *rentismo* that deepens the exclusion of lower-income people.

Graph 10. Remittances: Latin America and Cuba

Cuba, a mid-level recipient of remittances compared to the rest of Latin America



Source: Orozco M. Remittances to Latin America and the Caribbean: Money Markets and Costs. BID-MIF. 2002

Although it has been reported that around 60% of the Cuban population has access to dollars, that does not mean this revenue is received in a stable or uniform fashion. There is a clear, asymmetrical concentration in these flows. This is seen in the distribution of currency exchange houses (CADECAS) in Cuba's various regions. At the same time this appears to be related to the number of foreign tourism facilities a region has. This suggests that perhaps one component of the circulation of currencies is 'spillage' from tourism, such as tips and payments conducted outside the official state networks. However, one cannot rule out the possibility that this interpretation is also hiding other, less evidence transactions.

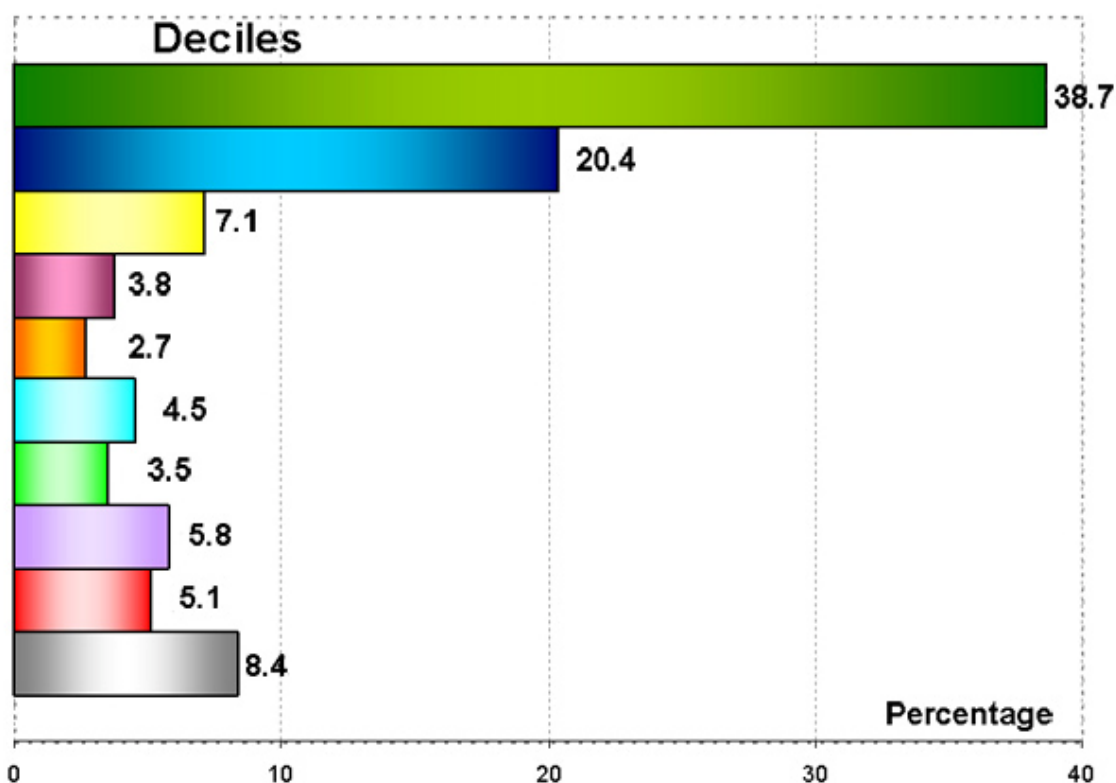
As far as remittances are concerned, the features that make Cuba stand out when compared with other Latin American countries that are recipients of these funds can be summed up as follows:

- The US Government's policy of making remittances a political tool for exerting financial pressure.
- The need to obtain special licenses from the US Treasury Department has led to a high concentration of transactions in certain companies that perform these services (in the US, Western Union and MoneyGram; from Switzerland, Internet Funds Transfer and AWS Technologies), rather than a large variety of companies and methods. This variety does exist in the rest of Latin America and has lowered costs for sending remittances.
- This trend that is the inverse of the rest of Latin America is also entrenched by the Cuban government as a result of its policy of transferring domestic transactions to other currencies and also the deposits of its overseas accounts (euros, Canadian dollars, etc) to avoid the sanctions that the US government has imposed as part of its sanctions against international banks that operate with Cuban dollar-denominated assets.
- Accumulation of most of these remittances through a state-run business network that sells consumer goods (*Tiendas de Recaudación de Divisas*, TRD in Spanish; the term translates as Stores that deal in Foreign Currency). This channels the money toward financing domestic business activity, with the Central Bank acting as an intermediary.
- A high degree of sensitivity to the bilateral political context: (it is greater in the source country, the US) The US policy of penalising/restricting the sending of remittances from the US, using this money as a foreign policy tool (OFAC, amendments, paragraph (a) section 5.570, Paragraph. (c)(4)(i) Section 515.560, Paragraph. (a)(3) Section 515.572 & Section.515.333).

- The minimal scale of the private business sector in Cuba, which renders it meaningless, in comparative terms, as a complement of social spending.
- Other forms of non-consumer spending linked to remittances; these are in fact seen elsewhere in Latin America, such as education, health and sanitation. These do not exist in Cuba.

Most studies have confirmed that remittances are spent mainly on consumer goods (food, clothing, electrical appliances, etc) and to a lesser extent for other purposes such as home repair, savings and quasi-investment in very small businesses. This last destination is the one which has the greatest impact in Cuba as a factor of social differentiation: the initial revenue is not ‘spent’ but rather ends up in small businesses that widen the gap income between those who receive remittances and those who rely exclusively on their regular wages. This process of social polarisation can be seen clearly in the graph below. It divides the population up by deciles of income and the percentage of remittances that each population group receives out of the total. In this study by the City of Havana (home to nearly two-thirds of Cuba’s currency exchange houses) we see that the two groups with the largest income receive nearly 60% of all the remittances that arrived in Cuba in 2004.

Graph 11. Distribution of recipients of remittances by income level in the city of Havana, 2004



Source: data from L. Añé, A. Ferriol & M. Ramos, ‘Reforma económica y población en riesgo en la Ciudad de la Habana’, Program on the Social Effects of Economic Reform Measures on the City, Diagnoses and Prospects, INIE-CEDEPE-ONE, 2004.

Therefore, remittances are a problem not just from the standpoint of macroeconomic management of financial flows. Rather, because of their very nature they pose new challenges for domestic policies in the areas of social compensation, wages and employment, to cite the most evident ramifications. However, the predominant view of the US government has been to view remittances simply as a net flow of revenue that helps the Cuban government stay afloat financially. For this reason, after winning a second term in 2004, President George W. Bush implemented measures to reduce the sending of remittances as much as possible.⁴⁵

⁴⁵ The amendments introduced by the OFAC were these: in the General License, paragraph (a) of section 515.570 reducing limits of quarterly shipments of money to Cuba, par. (c)(4)(i) secc. 515.560, and paragraph. (d)(1) secc. 515.570 for NGOs, paragraph (a)(3) secc. 515.572 for bank transactions with remittances and other similar institutions. Source: ‘OFAC Issues New Interim Final Rules for CUBA’, 16/VI/2004, US-Cuba Trade and Economic Council Inc., 2004 Commercial Highlights, www.cubatrade.org.

Based on the elements described above, one can draw some political implications, which we discuss here:

- Political tensions between the US and Cuba have resulted in high transactions costs for remittance flows. On one hand this stems from the toughening of the US policy of sanctions. On the other, Cuba has applied policies of reducing risk from financial exposure through holding assets in dollars, a circumstance which is in clear contradiction with the prevalent trend in Latin America. This restrictive environment is enhanced by the policy of selectively granting licences to few money-transfer agencies.
- As the Cuban economy has gradually diversified its sources of overseas financing and other sectors that generate hard currency gain strength, remittances have lost relative importance as a source of revenues.
- Changes in US policy in this area of economic relations with Cuba would not necessarily lead to a substantial increase in remittances: it is highly likely this change would include an easing of travel restrictions so some of the money that emigrants sent as remittances would be spent on visits to Cuba.
- Remittances do not only have a positive effect by expanding Cuba's hard currency reserves; they also pose important domestic policy challenges that are not restricted to US-Cuban relations.

5.4. Off-shore Oil

A new factor was added recently to the traditional farm business sector: oil in the Cuban part of the Gulf of Mexico. Cuban agencies have said Cuba has abundant reserves in that area, without providing details.⁴⁶ They have also said the 112 square kilometres that comprise the area have been divided up into 56 blocs, one part of which has already been negotiated. Cuba reached deals with Spain's Repsol-Ypf to exploit 20 blocs, of which six are in operation. Other foreign companies that are taking part, with four blocs each, are Canada's Sherrit Oil & Gas, Petronas of Malaysia, and Vietnam's Petro. Other companies from China, France, India, Malaysia, Norway, Venezuela and Vietnam are also in the exploratory phase or considering signing on.

All of this means that, for the first time in the history of relations between Cuba and the US, there is a 'strategic cost of maintaining the blockade'.⁴⁷ Word that oil might be pumped from waters off Cuba triggered reactions from the US Congress and there are now three proposals on how to do with this scenario.⁴⁸ One is sponsored by Florida lawmakers who are Cuban-Americans, Lincoln and Mario Díaz-Balart, and Ileana Ros-Lehtinen, as well as Senator Mel Martínez. It proposes legislation that combines environmental concerns with the traditional commitment to destroy the Cuban revolution by toughening the blockade, extending it to the oil sector. Mel Martínez wants to scare away potential investors by denying US entry visas to executives –and their families– of companies that strike deals with the Cuban government. Yet another proposal, from Senator Bill Nelson, aims to extend the US oil-prospecting area some 150 miles into the Cuban zone, seeking elimination of the maritime border treaty the two countries signed in 1997. A third proposal, from Senators Byron Dorgan, Jeff Flake and Larry Craig, will let American firms take part in oil-extracting operations through the current mechanism of the special licenses granted by the OFAC. This system would be modified to include oil companies and their subcontractors.

The Cuban government has said that making the country an oil exporter is not one of its immediate priorities. It follows the principle that 'oil is subordinate to economic policy, not vice-versa'.⁴⁹ The

⁴⁶ 'Abundantes reservas de petróleo, según empresa estatal', *Havana (ANSA)*, 13/VIII/2007, www.ansalatinna.com.

⁴⁷ BBC News, 9/XI/2006, <http://news.bbc.co.uk/1/hi/americas/5321594.stm>.

⁴⁸ Robert Sandels, 'The Specter of Cuban Oil Haunts the Blockade', *Cuba-L Analysis*, 6/VI/2007.

⁴⁹ *Granma International*, 1/VIII/2007.

government wants to place greater emphasis on strategic plans to overhaul domestic energy production, decentralising its structure with smaller-scale plants, along with a modernisation of grids and replacing equipment. Something that has changed Cuba's relative position in the immediate term is the opening of the Cienfuegos refinery, which has been re-fitted and modernised with a Venezuelan investment. This has placed Cuba in the position of being a processor and re-exporter of fuels at the regional level, geared mainly toward the Caribbean and the member countries of the ALBA accord.

A study by the US Geological Survey,⁵⁰ using a geological prospection method, estimated that Cuban reserves totalled 4.6 billion barrels of undiscovered oil, and an average of 9.8 trillion cubic feet of accompanying natural gas (8.6 trillion cubic feet of associated-dissolved gas, 1.2 trillion cubic feet of non-associated gas and an average of 900 million barrels of liquid natural gas in the northern Cuban basin). The Cuban company Cupet has reached an agreement with Pebercan to form a partnership (including operations and expenditures) for drilling several wells, with a budget of US\$111 million. If additional programmes are carried out this could climb to US\$183 million. The hope is for basic production of 13,000 barrels a day, and 18,500 if the conditional programme is implemented.⁵¹

The war in Iraq and high oil prices have created conditions in which a re-evaluation of Cuba's oil reserves in the Gulf of Mexico have provided even more leverage against the American trade embargo. There exists the perception that failing to act swiftly is only allowing competitors to gain the advantage. New players like the US firm Halliburton are reported to be lobbying against the restrictions imposed by the US embargo in the field of energy.⁵²

5.5. Restrictions on Access to the US Market

Access to the US market for goods and services in a scenario of normalised economic relations continues to be one of the trickiest problems to resolve. Both sides have multi-million-dollar claims pending against the other. Added to this are a set of special regulations that involve several US institutions and this would not be easy to dismantle.

The main federal agencies that currently control trade between the two countries under specially established powers are: the Commerce Department, the Bureau of Industry and Security (BIS) – which controls exports and re-exports to Cuba– and the Treasury Department, through its Office of Foreign Assets Control (OFAC). The latter is mandated to regulate all transactions that involve Cuban assets, including regulations that affect trips to and financial relations with Cuba. None of the regulations under which these agencies operate fall under what we might call 'standard procedures' for the rest of the countries of Latin America.

Another factor to consider is Cuba's claim for compensation over its costs as a result of the trade embargo. They are difficult to quantify, and take many forms. These include the re-directing of markets –with its implicit transport and insurance costs– technological impact, losses from re-directing exports, tourism and commercial flights, greater surcharges on foreign debt and migration of skilled labourers, to mention a few of the most widely recognised effects. However, the impact has also spread to third countries, with equally significant results. Cuba's accumulated, officially-registered losses now exceed US\$96 billion.

⁵⁰ World Energy Assessment Project Fact Sheet, Assessment of Undiscovered Oil and Gas Resources of the North Cuba Basin, mayo de 2005, <http://energy.cr.usgs.gov/oilgas>, North Cuba Basin Assessment Team (Christopher J. Schenk – Task Leader–, Thomas S. Ahlbrandt, Ronald R. Charpentier, Mitchell E. Henry, Timothy R. Klett, Richard M. Pollastro & Jean N. Weaver).

⁵¹ 'Tarara: Discovery of the New Potential Field', Pebercan Press Release (Canadá), 15/II/2006.

⁵² 'Oil Relief in Cuban Waters', *The Washington Post*, 18/VIII/2006.

Another pending issue for both governments is that of compensation for property seized by the revolutionary government in the first years after it took power. This is without doubt one of the most complicated issues to resolve because it has several fronts. Many of these require negotiations under a political and legal framework that establishes definitions, methods of assessment and plans for treatment. Without all this, it is difficult to conceive of Cuba and the US moving toward normalisation of economic relations in a broad sense.

One particularly important factor is that the Helms-Burton Bill of 1996 (*The Cuban Liberty and Democratic Solidarity Act*) drastically modified the US President's ability to negotiate. It restricted his margin for discretionary behaviour by forcing him to prove that the terms spelled out in the law were satisfied in order to change them.⁵³ The trade embargo was toughened after George Bush won a second term in 2004 to limit family trips, academic exchanges and all previous kinds of collaboration. In a general sense, the embargo continues to be the centrepiece of an obsolete and rigid strategy, one that is out of contact with the changing reality of the country and has no effective ability to achieve its ultimate goal, which is to bring down the Cuban government, as stated clearly by Julia Sweig: 'Cuba policy –aimed essentially at regime change– has long been dominated by wishful thinking ever more disconnected from the reality on the island..., reinforced by a political environment that rewards feeding the White House whatever it wants to hear'.⁵⁴

Given the US' loss of ability to influence events in Cuba, and Cuba's rejoining the international economy, a step which has given it good prospects of growth for the future, some analysts have come to believe that 'the end of the blockade may not be an urgent priority for the next generation of Cuban political leaders in the immediate future'.⁵⁵

A lifting of restrictions on Cuban exports would create competition for sectors that are particularly sensitive for Florida, such as tourism, fruit growers and the fishing industry. At the same time, trade itself would be back-fed by new opportunities for US companies to invest in new equipment, infrastructure (transport of merchandise, energy and telecommunications), agriculture, mining, construction, manufacturing and services, as occurred with companies in Canada and Europe.

So far, the trade embargo has managed to prevent some foreign investment in Cuba, but not stop this process altogether, and in no way has it helped bring about political change in the direction sought by Washington. In fact, the US business sector has been harmed by this law, which denies it the possibility to operate in a market which has shown it has real possibilities.

6. Some Final Observations

The growth that Cuba has achieved since 2004 holds some of the keys for understanding the country's future needs.⁵⁶ On one hand, in the last three years the economy has been fuelled by the overseas sector,⁵⁷ especially by revenue from sales of health care services and tourism. This has lightened the burden of the balance of payments, while sectors that produce material goods (agriculture, mining and manufacturing), with the exception of 2007, are showing annual growth levels that average nearly 1% (in the period 2001-06). This is the result of a process of continued deterioration in the production system and the loss of some avenues and growth stimuli that were generated in the 1990s (in particular, the effects that tourism and stores for recovering hard

⁵³ See an interesting analysis by Philip Peters in 'Transition in Detail', The Lexington Institute, Cuba Policy Report, 29/VI/2006.

⁵⁴ Julia E. Sweig, 'Fidel's Final Victory', *Foreign Affairs*, January-February 2007.

⁵⁵ 'En sus años finales, el bloqueo no es ni la zanañoria ni el garrote que solía ser', Philip Peters, *Ibid.*, p. 4.

⁵⁶ J. Triana Cordoví, 'La economía cubana en el 2005: crecimiento, reajuste funcional y consolidación del cambio estructural', CEEC, January 2007.

⁵⁷ P. Vidal Alejandro, 'Modelo para la predicción del PIB cubano', Quarterly Newsletter, CEEC, April 2007, www.uh.cu/centros/ceec.

currency had on the national industrial system). At the same time, within the service sector, the Cuban tourism industry is showing signs of clear decline and yielding ground to competitors in other markets in the region.

At least three questions emerge from this combination of circumstances:

- (1) Should Cuba repeat the old, structural deformation that was typical of its economy and encourage dependence on just one sector?⁵⁸
- (2) Should the domestic market be disregarded as a growth factor?
- (3) Should Cuba renounce an engine of growth such as tourism, which as far back as the 1950s was practically the second most important component of the economy and in the 1990s showed it could compete successfully in the region, despite being saddled with the handicap of not having access to the US market and lacking the ability to generate ripple-effect growth in the rest of the economy?

One cannot ignore the fact that the process of growth allowed Cuba to rescue its education and health-care systems. Both suffered serious neglect during the years of crisis and during the initial phase of recovery, and are essential for the continuity of Cuban socialism.

Nor can one ignore the complexity of growth processes and how they and the processes of structural change in the economy influence each other. In fact, one must take into account the possibility of apparently contradictory results; for instance, when sectors that create the most jobs are also the ones that yield the smallest gains in productivity.⁵⁹

What is Cuba to do? Answering this question forces us to provide a breakdown of the economy's current status, even if this is a bit synthetic:

- (Traditional) sectors that produce goods (agriculture, manufacturing and sugar-production)
 - Technological deterioration (the exceptions are nickel, tobacco and citrus fruits).
 - Low productivity compared to the rest of the world.
 - Low capacity for generating efficient jobs.
- Non-traditional productive sectors
 - Comparable to world leaders in some niche markets.
 - Highly concentrated in some sectors.
 - Relatively little spill-over into the rest of the system of production.
 - Low capacity for creating jobs, given the specific nature of their activities.
- Services: a mixed record
 - Tourism at a mature stage, with possible, moderate growth and needs for a re-launching.
 - Health-care services consolidated (but highly concentrated in just one market).
- Macroeconomic performance
 - *Trade-off* between centralization and growth.⁶⁰
 - Consolidated balance in the domestic realm and continued imbalance in the overseas sector.
 - Major distortions.
- Pricing system
- Exchange rate and monetary duality
- Wages

⁵⁸ J. Triana Cordoví, 'Cuba: los retos del crecimiento en una nueva etapa de desarrollo', CEEC Seminar, April 2007.

⁵⁹ R. Torres Pérez, 'Structural change and its possible effects on economic growth through sectorial movement of the workforce (1975-2003)', CEEC, January 2007.

⁶⁰ Y. Doimeadios & Y. Prado, 'Marco institucional: influencia en el crecimiento productivo en Cuba', FEC-UH, 2006.

- Little capacity to generate domestic savings, and low availability of external savings, despite an improvement in the availability of credit in recent years.

So, again, what should Cuba do? The answer: move ahead step by step, in a gradual process that avoids traumatic shocks:

Move to end distortions and provide incentives for the traditional productive sector, while protecting current equilibriums.

One way to contribute indirectly to a gradual process of eliminating Cuba's monetary duality⁶¹ would be to create an exchange rate for the business sector that would allow for measuring efficiency, creating incentives for exports and replacing imports, making better use of natural resources, which at the same time would mean a better performance by state-owned companies and the national economy, and also better allotment of resources, along with beginning to end the gap between the official exchange rate and the CADECA rate. This should be a step-by-step process that lets state-owned companies adjust, and also allows for systematic correction of the process.

Increasing real wages without raising their face value could be one of the first actions to take. Its positive effect would help Cuba recover the essential notion that wages are the main conduit for satisfying the needs of the majority of the population. To achieve this, the government might reduce the prices of the items in highest demand and most frequently purchased at shops that operate in foreign currency; this could be done by lowering taxes on sales of such goods. This would have a positive impact on redistribution of revenue and improve the consumption pattern of low-income sectors. It would also help agricultural markets through a replacement effect. Such a measure would also avert an increased money supply, which would result from raising nominal wages in a situation of weakness in productive sectors and difficulty in raising supply due to problems with the balance of payments.

Recovery of the agricultural sector could go hand in hand with this process from the outset, due to its effect on the population through food prices and also on the trade balance through replacement of imports.⁶² However, the undercapitalisation of the sector, along with emigration by the work force and the consequent abandonment of Cuba's farms, make one think that this recovery should have modernisation and recapitalisation as fundamental components. This requires a strong capital investment, which the State is probably not able to provide from the outset. For this reason it is reasonable to think about foreign investment in this sector. Cuba has had successful experiments with foreign investment in agriculture: it is seen in the recovery of citrus fruit and tobacco production.⁶³ Cuba might try to encourage families to go back to working the fields, and has experience with this, but there would have to be sufficient material incentives for them to do so.

Another measure would be to expand the market, freeing up access to goods and services. This would enhance incentives for people to work, and preserve macroeconomic balances, with a positive effect on aggregate demand. It would also serve to crack down on the black market, reducing its size both physically and in economic terms.

Re-launching small- and medium-size cooperative (and private) companies

This would relieve the State of commitments that are not essential for strengthening the socialist economy and at the same time generate an entrepreneurial network that would boost the efficiency

⁶¹ P. Vidal Alejandro, 'Redimensionando la dualidad monetaria', quarterly newsletter, CEEC, August 2007, www.uh.cu/centros/ceec.

⁶² A. Nova González, 'La producción agropecuaria en el 2006 y sus retos', Quarterly Newsletter, CEEC, April 2007, www.uh.cu/centros/ceec.

⁶³ Obviously, there are substantial differences between promoting foreign direct investment in sectors with a secure external market and doing so in the domestic market: guarantees of recovering money invested and problems associated with land ownership can be greater. Still, this can be done.

off the system as a whole, by redirecting some of the money spent today on maintain unproductive companies toward social sectors. However, small- and medium-size companies (cooperative or privately owned, depending on the specific situation) should be conceived of as complements to the state production system or a substitute for the state system for services such as trade and gastronomy, and to encourage outsourcing.

Here, two strategic issues must be noted. The first has to do with the very nature of the workforce in Cuba, which is highly skilled and distributed quite equally throughout the country's different territories.⁶⁴ This would be a good incentive for a sector of small- and medium-size companies involved in technology or high value-added services for the state production system. The second issue is the role such companies could play in development projects at the local level. This stems from their ability to make efficient use of tacit and explicit knowledge of their territory, and thus complement state-run companies operating at the national or local level. It is a question of making this sector serve socialist goals and get it working for the nation as a whole.

Stimulating new foreign investment by adding new priorities

For the most part Cuba's experience with foreign direct investment has been successful,⁶⁵ meeting the goals for which it was conceived. That said, if we look at the country's current needs, it is clear that Cuba can find new opportunities for such investment or concentrate efforts where the government is trying to boost the economy significantly. Among these new and not-so-new areas of opportunity, foreign direct investment could contribute to:

- Generating efficient jobs in productive sectors (in particular, agriculture and manufacturing), something which in general has been achieved in those sectors in which foreign investment has helped boost production.
- Encourage national, productive integration, especially in those segments which allow for increasing exports.
- Complementing the chain of production toward the domestic market.
- Rebuilding and modernising the infrastructure of productive services, in which Cuba has already succeeded in the area of telecommunications.

Obviously, this new era of transformation also requires parallel processes in the legal, institutional and planning realms. These must give the transformation the coherence, solidity, transparency and legitimacy that these realms require within the framework of Cuban socialism.

In a later stage, after reactivating the sector that produces material goods, Cuba would have to work to end the economy's duality and the gap between exchange rates. It would have to start this process within companies and work toward the population, aligning the business sector in the direction of productivity, efficiency and competitiveness. This would force a re-thinking of the system of entrepreneurial improvement so as to align businesses' internal systems with these new changes. Also required are reviews of wage policy and an updating of the tax system.

Time is certainly the most scarce resource in any process of transformation, but haste should not be allowed to hinder or block progress. Time is needed to allow the necessary institutional adjustments, facilitate modifications in regulatory systems and let people get used to this new environment.

Quite surprisingly, Cuba does have time. Among other reasons, as far back as the 1990s Cuba managed to survive even worse conditions, when the fall of the communist bloc and the Soviet Union, added to structural problems that were never resolved in the development strategies adopted

⁶⁴ S. Odriozola Guitart, 'Hacia una nueva concepción del capital humano en Cuba', FEC-UH, 2007.

⁶⁵ O.E. Pérez Villanueva, 'La inversión extranjera en Cuba: ¿avances o retroceso?', CEEC, January 2007.

in the 1960s, triggered the deepest economic crisis in Cuban history. Then, a process of transformation was implemented under extreme conditions. Cuba was literally on the verge of economic collapse. The process allowed for creating new sources of growth and re-launching the economy on another set of functional pillars. Now, Cuba has time because there is a domestic atmosphere of political stability and governability; because unlike years ago, in today's regional and hemispheric political context, absurd policies of isolation are frowned upon. Rather, there is a preference for integration models that represent new opportunities. To sum things up, Cuba has time because its domestic and external economic relations are incomparably better than they were 14 years ago. And if back then the country managed to overcome such difficult circumstances, today the challenge seems less daunting, even though many things taken as truths until now might fall by the wayside.

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