

# Cuba's Economic Performance and the Challenges Ahead

*Archibald R. M. Ritter*

BACKGROUND BRIEFING

## EXECUTIVE SUMMARY

In the early 1990s Cuba experienced a deep economic crisis. In the face of this near "melt-down" of the economy, Cuba's leadership modified the basic development strategy with a number of institutional and policy innovations. By 1995, the Cuban economy had begun a process of recovery, but it has been uneven and the economy has not returned to pre-crisis levels. Cuba's economy was further hurt by the international economic slowdown of 2001, which was also intensified in the aftermath of the September 11 terrorist actions.

This paper reviews Cuba's economic fortunes since the 1990s, outlines the Cuban government's policy responses and explores the prospects for an enduring economic recovery. Although in the short term the Cuban economy cannot avoid being affected by the international slowdown and the after effects of September 11, in the longer term, Cuba's economic performance will depend on a variety of other factors. Among the positive factors are basic levels of human development, well-developed institutions in parts of the society, the backlog of innovations in the outside world awaiting implementation in Cuba, the country's tourism potential, and the large US market.

An enduring economic recovery that allows for the maintenance of investments in social areas, however, requires that Cuba address a number of daunting challenges. These include expanding and diversifying exports, increasing investment levels, terminating the monetary and institutional dualism, creating an appropriate environment for self-employment and small and medium scale enterprise, and addressing other institutional and policy problems and information control.

## RESUMEN

Ante la profunda crisis económica que sufrió Cuba a inicios de los años 90, la dirigencia política del país decidió modificar su estrategia de desarrollo mediante la aplicación de un grupo de reformas políticas e institucionales. En 1995 la economía cubana comenzó un proceso de recuperación que ha sido inestable y que aún no llega a los niveles anteriores a la crisis. Esta situación se ha visto agudizada con el descenso de la economía internacional en 2001, el cual se hizo aún más crítico a raíz de los ataques terroristas del 11 de septiembre.

El presente trabajo analiza la trayectoria que ha tenido la economía cubana desde los 90, presenta un bosquejo de las respuestas del gobierno cubano y examina las posibilidades

para una recuperación duradera. A corto plazo, la economía cubana no podrá sustraerse a la recesión internacional ni a los efectos del 11 de septiembre. A largo plazo, su recuperación estará sujeta a distintos factores. Entre los factores positivos cabe señalar los niveles básicos de desarrollo humano, instituciones bien establecidas en determinados sectores de la sociedad, la cantidad de innovaciones que se producen en el mundo y que esperan por ser aplicadas en la isla, el potencial turístico del país, y el amplio mercado estadounidense.

Sin embargo, para lograr una recuperación sostenida que permita el mantenimiento de las inversiones en el sector social, Cuba deberá resolver enormes desafíos: expansión y diversificación de las exportaciones; aumento en los niveles de inversión; eliminación de la dualidad monetaria e institucional; creación de un entorno propicio para el autoempleo y el establecimiento de pequeñas y medianas empresas; y hacerle frente a un grupo de problemas de carácter institucional relacionados con la elaboración de políticas y el control de la información.

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## BACKGROUND: CUBA'S ECONOMIC CRISIS AND THE POLICY RESPONSE

In the first half of the 1990s Cuba experienced a deep economic crisis. The essential cause was the decline in foreign exchange receipts — by 75% to 80% from 1990 to 1993 — resulting from the termination of the hidden subsidization inherent in the country's special trade and aid relationship with the former Soviet Union and the countries of Eastern Europe. In fact, this economic crisis emerged after a period of worsening economic difficulties in Cuba from 1985 to 1990. Among the other factors that contributed to the crisis were:

- the fragility of Cuba's economic structure, in that few enterprises, "clusters" of economic activities, or sectors were healthy and internationally competitive;
- a lack of export diversification much beyond the pattern of the 1950s;
- inflexibilities in the central planning system;
- some continuing policy pathologies;
- limited access to international credit, since Cuba declared a moratorium on debt servicing in 1985;
- a hardening of the US trade embargo with the imposition of the 1992 "Torricelli" bill; and,
- the loss of some export markets in Eastern Europe.

The result was a multidimensional crisis, which led to a sharp decline in living standards for Cuban citizens between 1989 and 1994 (see figures for GDP per capita in Table 1). The overall crisis included the following elements:

- a macro-economic crisis, with a decline of approximately 40% in output per person, due to the shortage of foreign exchange for the purchase of imported energy, raw materials, intermediate products, capital goods, food etc.;

- an energy crisis, with consequent electrical blackouts and reductions in transportation services leading to industry shut-downs;
- a food crisis, with both reduced domestic food production and reduced food imports damaging general levels of nutrition;
- a collapse of savings and investment – Cuba's entire capital stock deteriorated rapidly due to limited replacement investment, postponed maintenance and repair, and "cannibalization" of equipment in some sectors;
- aggravated under-utilization of the labour force, reflected in increased unemployment and underemployment;
- reduced taxes, rising fiscal deficits, accelerated money creation, and an escalation of inflationary pressures;
- a monetary crisis in which the purchasing power of the Cuban *peso* declined precipitously, leading to a burgeoning demand for US dollars and a subsequent "dollarization" of the economy;
- large reductions in the real purchasing power of public sector budgets (i.e. education, public health) as well as in the *peso* incomes of public sector employees, with consequent pressure on the provision of social services.

Citizens responded to the decline in their standard of living by pursuing self-employment activities, most of which were illegal at the time, resorting to illegal or black market activities and exchanges, and finding means to acquire US dollars which were vital for survival.

In the face of this crisis and the desperate need for foreign exchange, Cuba's leadership announced the "Special Period in Time of Peace", an era which has lasted from 1990 through 2002, in which tough policies were deemed necessary to deal with difficult

circumstances. The leadership modified Cuba's basic development strategy with a number of institutional and policy innovations designed for the new international context within which Cuba had to survive. Between 1993 and 1996, the Government of Cuba implemented a variety of institutional reforms including:

- legalizing the holding of US currency;
- liberalizing remittance payments from relatives abroad;
- legalizing self-employment in some low technology areas;
- re-establishing agricultural markets;
- liberalizing the foreign investment law;
- converting state farms to quasi-cooperatives;
- creating four export processing zones;
- re-invigorating small-holder farming;
- re-organizing the state enterprise system and ministries;
- implementing some banking reforms.

The policy reforms included a re-establishment of a reasonable fiscal balance, with consequent reductions in money creation and inflationary pressures; reduced subsidies to enterprises; significant changes in the structure of the taxation system, and major reductions in military expenditures. By 1996, most of the economic reforms were in place. A few additional reforms were introduced after 1998 such as administrative reforms for state enterprises (*"Perfeccionamiento Empresarial"*), but the principal priority seemed to be assimilating the changes already in place.

### **ECONOMIC PERFORMANCE DURING THE "SPECIAL PERIOD": THE EXTERNAL SECTOR**

The institutional and policy changes adopted in the 1993-1996 period arrested Cuba's economic meltdown. As this section illustrates, many of Cuba's key economic indicators began to improve after 1994 or 1995, continuing through to 2002. This was true for foreign exchange earnings, output levels, petroleum extraction and energy availability, food production and availability, tax revenues and the fiscal balance, monetary indicators and labour force utilization.

The constraint on economic performance, however, continues to be a shortage of foreign exchange for purchasing imported capital goods, petroleum, intermediate inputs and consumer products, especially food. Indeed, the acquisition of foreign exchange is of such overriding importance that a re-design of Cuba's basic development strategy was necessary in the new context of the "Special Period".

#### **Merchandise Exports**

Merchandise exports were essentially stagnant in the 1990s. The volume of Cuban exports in 2000 was 68.6 % of the 1989 level, and the purchasing power of those exports dropped to 34.2 % of the 1989 level (NU CEPAL, 2001B, p.27). The deficit in merchandise trade expanded, reaching \$US 3.2 billion by 2000 (see Table 2).

Sugar exports have been particularly disappointing. The cause seems to be intractable production problems in agricultural and milling processes, and not a shortage of potential markets. The harvest of 2001

totalled 3.5 million tons, among the lowest yields of the last 50 years, and not a good omen for the future. On the other hand, exports of nickel concentrate — about half of it to Canada for refining — have increased significantly, reaching over 27% of total exports in 1999. This is due in part to the production-enhancing investments in the joint venture with the Canadian enterprise, Sherritt International. Cigar

exports also expanded significantly prior to 2000. Cigars were Cuba's third largest merchandise export, accounting for 11.8% of total exports in 1999. On the other hand, despite high initial expectations, biotechnological exports have not performed well and accounted for only 1.8% of total merchandise exports in 1999 (NU CEPAL, 2001B, p.28).

#### **Tourism and Family Remittances**

Cuba's most noteworthy success in its international economic interaction has been the expansion of international tourism. Recent estimates of gross tourism revenues for 2000 are \$US 1.9 billion. Family remittances from the Cuban diaspora are also a significant source of foreign exchange. While it is difficult to accurately calculate remittances, they were estimated to be \$US 720 million in 2000 (see Table 2).

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## Foreign Direct Investment

Foreign Direct Investment (FDI) in the form of joint ventures with state enterprises has been of major importance to Cuba. While there is some doubt about the volume of FDI, the United Nations has estimated it at \$US 1.6 billion for 1993 to 1999 (see Table 2). Some of the principal sources and sectors for foreign investment have been Canada (nickel, petroleum extraction, electricity generation, tourism, brewing, and paper) Spain (tourism and cigars) and Mexico (telephones).

While foreign investment may not seem large in terms of its overall volume, it has been the vehicle for valuable transfers of technology. In some cases, these have been environmentally friendly and energy efficient, particularly in comparison to vintage Soviet technology. For example, new technologies introduced by foreign partners – mainly Sherritt International –

have dramatically increased petroleum extraction. Sherritt also introduced technologies for generating electricity using the natural gas previously “flared” or wasted, and has invested in a gas pipeline from Varadero to Havana. Foreign enterprises have also introduced the latest management systems, notably in the tourism sector, in which foreign hotel firms have a significant presence. Finally, foreign enterprises in joint venture

arrangements often have the marketing expertise, networks and muscle to facilitate market access for Cuban products. In the tourism sector, for example, foreign hotel chains and tour operators promote Cuban destinations. *Habanos S. A.*, a cigar marketing joint venture which is 50% owned by *Altidis* (a Spanish-French firm which has a near-monopoly of cigar sales in Europe) is another instance in which Cuba is relying on a foreign firm’s marketing strength to expand revenues from exports.

Unfortunately, outflows of profits and interest payments on debt also have reached high levels. These outflows made up a large proportion of the \$US 670 million deficit in factor service payments in 2000 (Table 2). Cuba may have entered a situation in which profit remittances by foreign firms continually exceed new direct foreign investment. From 1994 to 1999, for example, the burden of interest payments plus profit repatriation of \$US 2,942 million (the major components of the factor service deficit) exceeded

the accumulated investment inflow of \$US 1,504 million (Table 2).

## International Credit

Due to the moratorium on debt servicing declared in 1985, Cuba has had to endure its economic crisis of the 1990s without significant access to the major sources of international credit. Cuba is not a member of the international financial institutions such as the International Monetary Fund, the World Bank and the Inter-American Development Bank. When it rejoins these, however, it will have significant volumes of credit available at zero “conditionality”, that is, with no external conditions for its use. Additional credit would then also be available from these institutions based on levels of “conditionality”. Although Cuba has had some limited access to other sources of credit, such as commercial banks, suppliers, or official lending agencies, it has also found it necessary to borrow

short-term with high-interest loans from lenders such as Sherritt International, to finance export activities such as sugar as well as to purchase imports.

The relative lack of access to international credit allowed for only a limited cushioning of the shortage of foreign exchange in the 1992-1998 period. There was no possibility of jump-starting the economy with

external financial support for the importation of the necessary inputs and capital goods, to permit a more rapid macro-economic turnaround in the style of the Czech Republic, Poland, Slovakia, Slovenia or Hungary. This has meant that Cuba has had to implement a harsh process of structural adjustment that has led to serious reductions of real living standards particularly for people in the peso economy such as pensioners, employees in state enterprises and workers in education, medicine and the public service.

## Cuba’s Debt

These financial problems are exacerbated by Cuba’s debt service problem. Cuba’s total convertible currency debt (excluding the debt to the successor states of the former Soviet Union) stood at \$US 11 billion in 2000 (NU CEPAL, 2001B, p.36). Its debt-to-export ratio continued to be higher than the Latin American average. In 1998, this ratio was 289% compared to 224% for the region (UN ECLAC 2000, p.107). Unfortunately, despite years of discussions with the

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“Paris Club” (an association of its governmental creditors), Cuba has not yet resolved this impasse. The debt to Russia is also significant, amounting perhaps to \$US 27 billion. The estimation of the value of the debt is contentious, however, and is considered to be zero by Cuba. This complicates the relationship between the two countries. Despite this, Russia continued to be Cuba’s largest export market until 2000, importing large amounts of Cuban sugar in exchange for oil until Venezuela became the major supplier of petroleum.

## **ECONOMIC PERFORMANCE DURING THE “SPECIAL PERIOD”: THE DOMESTIC ECONOMY**

During the 1994-2000 period, the general improvement in the external sector from tourism, family remittances, nickel and tobacco exports and direct foreign investment, ignited economic growth on the island. As a result, Cuba’s economic growth was positive in the 1996- 2000 period, averaging 3.9% in per capita terms (see Table 1). By 2000, GDP per capita had recovered significantly, although it was still about 17% below the 1989 level. To the casual observer, there are a variety of signs of economic recovery such as fewer electricity “blackouts”, increased public and automotive traffic, fewer bicycles on the street, a major expansion of dollar store retailing, and the accelerating restoration of Old Havana, for example.

### **Real Incomes**

It is difficult to estimate accurately the real incomes of Cuban citizens during the 1990s. This is because there is no reasonable measure of true inflation, such as a consumer price index which allows fully for the changing mix of consumer purchases from the rationing system, the dollar stores, the agricultural markets and the self-employment sector — not to mention the pervasive underground economy. The quantity of goods and services available through the low-priced rationing system has declined sharply. Products that were previously rationed are now often available only for US dollars in dollar stores where prices are at world levels plus a 140% mark-up (an implicit sales tax). As people spend a growing proportion of their income in dollar stores, the authentic purchasing power of regular incomes has diminished.

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Despite the measurement difficulties, analysts from the Economic Commission for Latin America and the Caribbean (ECLAC) estimated that the average monthly salary in *real* terms in 1998 was 54.8% of the level in 1989, a decline of over 45%. Another analysis by V. Togores also estimated that incomes in 1998 stood at about 56% of 1989 levels, however, this reduction occurred in three stages: first a 75% reduction from 1989 to 1993, then a significant recovery in 1995-1996, followed by stability from 1996 to 1998. Those without access to US dollars from tourism, foreign travel, or family remittances have experienced a drastic decline in real income. For this reason, professionals such as doctors, public officials, state employees and pensioners, are desperate to earn additional income by driving their family cars as taxis, becoming self-employed, or finding income supplements. The broad range of income supplements includes such things as illegal sales of products under one’s control, gratuities for service providers such as manicurists, estheticians, doctors, and private teachers, and re-selling the newspaper *Granma* for US dollars. Without sources of income such as these, many people would be destitute.

### **Education and Social Services**

Despite reductions in per capita income, Cuba has done a good job of maintaining the levels of education and social services achieved in the relatively prosperous 1970s and 1980s. Most major indicators of health and educational coverage have improved or at least have not deteriorated. The exception is higher education, where enrolment declined from 242,400 in 1990-1991 to 102,600 in 1998-99 (NU CEPAL, 2000A, Table A62). This was partly because of a decision to adjust for a previous oversupply of some types of professionals and partly because of the reduced incentive for young people to prepare themselves for low-paying *peso*-sector professional careers.

Official budgetary figures for health and education suggest that spending in *pesos* has been more or less maintained in these areas. However, these figures do not take into consideration the real level of inflation, which has reduced the actual value of *peso* budgetary allotments to these sectors. As a result, the real incomes of teachers, professors, doctors, nurses and other health and education workers, as well as maintenance of schools and hospitals, and the

availability of supplies have been seriously reduced. Anecdotal evidence suggests that the quality of education and health services has suffered in consequence.

### **Petroleum Extraction and Food Production**

Perhaps the most successful areas of the domestic economy have been petroleum extraction and food production. Although there has not been a full recuperation to previous levels of food availability, food production has benefited from institutional changes, particularly the establishment of the agricultural markets. As already mentioned, the increase in petroleum production is principally a result of the joint venture with Sherritt International. Domestic petroleum extraction now generates about 70% of Cuba's electricity, assisted by previously flared natural gas in the Varadero area.

### **Taxes**

Another successful area of reform has been in taxation or fiscal policy, which has restored the fiscal foundation for social programs and the functioning of the state apparatus. The fiscal situation in the early 1990s was in crisis, as the deficit escalated to 36.0% of GDP in 1993. This deficit was largely financed by money creation, leading to rapid though suppressed inflation. The result was a devaluation of the *peso* in the parallel market to about 150 *pesos* per US dollar in 1994, and a flight to the US dollar as a haven for savings. A series of difficult tax reforms involving a number of tax increases reduced the deficit to about 2.0% of GDP by 1998, and to a degree restored the value of the *peso* and confidence in it. The *peso* has not returned to the parallel market value it maintained during the 1980s, but it remained at 20 to 22 *pesos* per US dollar until late 2001, when it declined in value to 26 *pesos* per US dollar.

## **CONTINUING ECONOMIC CHALLENGES**

As Cuba enters 2002, it faces a number of ongoing challenges ranging from policy pathologies to institutional problems. These will require appropriate policy and institutional reforms in order to achieve a solid foundation for an enduring economic recovery.

### **Raising Investment Levels**

One of the more pressing challenges is to expand investment. According to ECLAC, "gross investment" levels collapsed by 87% from 1989 to 1993 (UN ECLAC, 1997, p.352). By 1998, Cuba's gross

investment as a percentage of Gross Domestic Product (GDP) was 7.9%, compared with 21.1% for Latin America and the Caribbean for the same year (NU CEPAL, 2001B, p.130 and 291). Taking depreciation into account, the real contraction of the capital stock must have been particularly serious in these years, due to lack of maintenance, cannibalization of machinery and equipment, and the accelerated decay which accompanies industrial shutdowns and lack of use. A chief source of low investment levels is a low level of national saving. In 1998, national savings amounted to only 6.4% of GDP, compared to 20.2% for all Latin American and the Caribbean (NU CEPAL, 2001B, p.291 and NU CEPAL, 2000B, p.83).

Investment has recovered somewhat since 1994, but this has been rather slow and is also concentrated in certain sectors, notably tourism. The magnitude of the task of renovation, reconstruction and re-equipment in areas such as housing, urban infrastructure, public buildings and the stock of vehicles is apparent even to the casual observer. Moreover, much of the old equipment from the Soviet Bloc is obsolete, prodigious in its use of resources, environmentally unfriendly, and internationally uncompetitive. Eventually, Cuba's investment effort will have to increase significantly, so that economic growth can become sustained, broad-based, and environmentally sound, and so that real incomes and social programs can recover.

### **Improving the Structure and Functioning of Economic Institutions**

A second challenge is Cuba's need to reform its state enterprise sector to make it effective and efficient. In a major study of the Cuban economy published in 1997, United Nations analysts concluded that "like other socialist countries of Eastern Europe, the Cuban development model was already becoming inoperative prior to the 1989 collapse" (UN ECLAC, 1997, p.120). Cuba is currently trying to overcome weaknesses in its centralized system of economic management, mainly by decentralizing enterprise financing, decision-making and responsibility. Whether it will succeed this time, after disappointing results with earlier attempts, remains to be seen.

A further challenge is to develop an effective way to manage micro- and small-scale enterprise. Self-employment in non-professional activities was legalized in September 1993. It has generated employment, raised tax revenues, provided valuable

goods and services, utilized domestic resources and contributed to foreign exchange earnings. However, higher incomes in some areas of the self-employment sector led the government to introduce regulations and constraints and an onerous tax regime, all designed to reduce incomes and restrict sector growth. Many of the self-employed view these policy measures as an attempt to contain if not asphyxiate them. The measures have had negative consequences such as the promotion of the underground economy and theft from the state sector. An appropriate regulatory environment for small enterprise could increase the benefits and reduce the negative effects in this sector. Opening self-employment to all who wish to enter would increase competition, increase supplies of goods and services, thereby lowering prices and normalizing incomes.

Perhaps the most serious weakness of the existing enterprise regimen arises from the continued ban on professional self-employment. The absence of small-scale enterprise in business services, scientific and engineering services, computer services, management and consulting services and innovative high-tech manufacturing areas is a liability for Cuba. These activities have expanded rapidly in other countries. They foster innovation, provide specialized services in an efficient way, and facilitate the diffusion of new technologies through networks of independent professionals. While there has been an attempt in Cuba to establish state enterprises in some professional service areas, they are generally bureaucratic, cumbersome, and subject to uninformed external authority. All of this hampers their agility, motivation to take risks, and ability to be innovative.

### **Terminating Monetary Dualism**

A third general challenge for Cuba is addressing the quasi-official “dollarization” which currently shapes Cuban society and the economy. The place of the US dollar has steadily strengthened and expanded since its legalization in 1993. The Cuban economy relies heavily on inflows of US dollars from family remittances (mainly from the United States), tourism and tourist spending. The government acquires US currency through the dollar stores, often called “stores for the collection of foreign exchange”. It also requires citizens to pay taxes and fees for some public services, such as passports, exit visas and airfares for *Cubana de Aviación*, in US dollars.

There are two exchange rates for the Cuban *peso*. The first is the official parity rate of \$US = 1 *Peso* used for

much international trade and internal public accounts. The second is a quasi-official rate that has varied from 21 to 26 *pesos* per dollar. This is the relevant exchange rate for citizens when they are buying or selling *pesos* and dollars for everyday use.

The co-existence of *peso* and dollar currencies and economies in Cuba, together with the dual exchange rate system, generate a variety of problems. The basic reason for this is that the average wage and income are somewhere between \$US 9.00 and \$US 17.00 per month at the quasi-official exchange rate. (The average wage in Cuba was estimated at 232 *pesos* and the average income from all sources at 359 *pesos* in 2000, according to the *Centro de Estudios de la Economía Cubana*). This means that those Cubans with access to US dollars from remittances, foreign travel, or tips and gratuities from tourism, for example, have generally had higher real incomes than those without access to dollars. Moreover, as noted earlier, ever-increasing proportions of goods and services are available for dollars in dollar stores and not for *pesos*. The result is that Cubans have been “chasing dollars” since the early 1990s. In other words, there has been a strong incentive for people to leave or reduce those economic activities that earn *pesos*, and enter or expand those which earn dollars. The result is that the general structure of material rewards in Cuban society bears little relationship to the true social value of the employment generating the incomes.

The Cuban Government also loses the *seigniorage* from the use of the US dollar. The US dollars in circulation in Cuba must be earned (except for that received as remittances) so that the *seigniorage* is “captured” in large part by the US Federal Reserve and ultimately the US Government.

From an economic perspective, it would be desirable to unify the exchange rates and the *peso* and dollar economies within Cuba. It would also be of major benefit to restore the *peso* as a strong convertible currency which citizens and others would be anxious to utilize for normal monetary purposes. The probable types of policies necessary for monetary unification would involve a devaluation of the current official *peso*/dollar parity exchange rate, and a realignment of the general structure of prices and salary/wages. This would not be easy, of course, and Cuba does not yet seem ready to deal with this issue head on.

### **Expanding and Diversifying Exports**

A fourth challenge is to expand and diversify merchandise exports. With the exception of nickel and

tobacco, Cuba's exports have not been particularly dynamic. Indeed, the structure of Cuba's merchandise exports in 2002 is surprisingly similar to what it was in 1960, with sugar eclipsed while some other traditional exports have expanded. Ultimately, Cuba will need to diversify as well as expand its exports if it is to achieve a sustainable economic recovery. This will require a variety of policy changes. Unification of the exchange rate and the peso and dollar economies is particularly important. At present, enterprises in the peso economy such as those in the sugar sector receive only one peso for every dollar of foreign exchange earned through exports. Obviously this reduces or destroys both the incentive and the real capability to export. Export diversification is also hindered by the inability of state enterprises to adapt quickly to the character of foreign demand. Liberalizing the rules of operation for small- and medium-scale enterprise would therefore be especially helpful. Finally, normalizing relations with the United States would open a vast and geo-economically sensible export market, not to mention a new source of tourists.

**Allowing for Independent Analysis and the Diffusion of Information**

Another challenge for the economy concerns the quantity and quality of information and independent analysis. The transfer of knowledge and the ability to communicate freely are indispensable in any economy and society. Open analysis and criticism provide a mechanism for self-correction, exposing flawed policies and errors, bringing illicit actions to light and suggesting alternate courses of action. These interactions can occur through the media, specialized and professional publications, professional associations, educational institutions and programs, non-governmental organizations and informal communication. Although this happens to some degree in Cuba, official secrecy limits the availability of information on many aspects of the economy. Moreover, information diffusion seems to operate with a "good news only" bias, or on a "public's need to know" basis. Equally damaging, economic analysts or writers are required to play a public relations role for official public policy decisions rather than to be independent critics.

The blockage of access in Cuba to the website of the *Instituto Cubano de Economistas Independientes* is a recent example of the imperative of the Cuban Government to control access to information and

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analysis. An example of the reluctance of the government of Cuba to permit analyses it is unable to control, is its withdrawal from participation in the *2001 Human Development Report* of the United Nations Development Program (UNDP). One suspects that the reason for this is official dissatisfaction with the previous *2000 UNDP Human Development Report*, in which Cuba ranked 13<sup>th</sup> in Latin America and the Caribbean for the "human development index" and third for the "human poverty index".

**Controlling Corruption**

An additional challenge is corruption, a phenomenon that has long existed in Cuba but which has again emerged as an area of major government concern. Corruption manifests itself in a number of different ways. Supplies such as agricultural products are stolen from the state sector at the production, transportation or wholesale-retail levels for illegal exchange on the "black market" and for house-to-house delivery. For instance, tobacco and cigars leak from the state sector to supply the ubiquitous market for counterfeit cigars of

varying quality in the dollar market. Some people with access to public goods use public property, such as cars and their drivers, for private purposes. The importance of this issue for Cuba's leadership is apparent from the large police presence on the streets of Havana, which is oriented partly to stopping the illegal circulation of products as well as theft. The

establishment in June 2001 of the *Ministerio de Auditoria y Control*, aimed at curbing corruption, particularly within the state sector of the economy, is a further indicator of the significance of this issue.

A further element of corruption is the pervasive Party patronage phenomenon in which employment, especially at higher levels (including economic institutions), and various types of material reward (such as housing, foreign travel, television sets and automobiles) are based more on Communist Party linkages and certification and less on relevant qualifications. This cannot help but impair the effective functioning of the economy.

**IMMEDIATE ECONOMIC CHALLENGES POSED BY THE EVENTS OF 2001**

The policy and institutional challenges described above will have to be addressed in the context of a number of recent world and local events that have had important impacts on key drivers of the Cuban economy.

First and foremost is the international economic contraction, which was already underway in early 2001, and intensified after the September 11 terrorist attacks. In the short run, a substantial proportion of the traveling public was “spooked”. Air travel to many destinations, including tourist destinations, diminished. Employment cuts then spread through the airline industry and tourist destinations throughout the world. Levels of business investment in general have also declined significantly. Despite these problems, it is possible that an up-turn in the international economy may occur rather quickly.

The Cuban economy cannot avoid the effect of the international economic slowdown. Tourism is the most vulnerable sector. According to a speech by Fidel Castro on November 2, 2001, tourist arrivals to Cuba declined by about 10% in September and 14% in October. This may be short-lived, however, if confidence in the security of air travel is quickly re-established. It is of interest to note that Fidel Castro spoke strongly against terrorism from any source following September 11. Even more significantly, Cuba finally agreed to sign all 12 United Nations accords against terrorism. These actions were aimed at maintaining a reputation for security, one of Cuba’s key tourism assets.

The cigar industry is another vulnerable sector. In view of their high price, cigars are considered luxury items and an international economic downturn may reduce their market significantly. Nickel export volumes and earnings have also declined. In addition, damage to export sugar and citrus crops as well as sugar mills in the Matanzas area from Hurricane Michelle (which struck on November 4, 2001) will likely contribute to a short-term reduction in exports. The storm also damaged electrical and communications systems and up to 10,000 homes.

Cuba’s foreign exchange earnings will also be affected by the recent closure of Russia’s radar facility or “spy base” at Lourdes, announced in October 2001 by President Vladimir Putin. Military rental payments and military procurement from Cuban sources will be lost, as well as consumer purchases and housing rentals by the 2000 Russian citizens who staffed the base. The total reduction of foreign exchange accruing to Cuba from the base has been estimated at \$US 200 million.

These factors have led to a reduction of foreign exchange available to Cuba in the immediate

and short term. Even before September 11, Cuba was facing difficulties in repaying the short-term trade credits it had obtained from Spain, France, and suppliers in Chile, Panama and South Africa (Cuba Business, September 2001, p.3). The official shortage of foreign exchange led the Cuban government to increase its purchases of dollars in the official exchange houses (*Casas de Cambio or Cadecas*) within Cuba. The government appears to be purchasing unlimited volumes of US dollars while limiting US dollar sales. By October this action had pushed the quasi-official exchange rate to 26 pesos per dollar from the 20 to 22 pesos per dollar rate which had been maintained for some years.

The economic deterioration was such that in a major speech delivered on November 2, 2001, intended to maintain public confidence, Fidel Castro assured Cubans that: the *Cadecas* would not close, all bank accounts in pesos, dollars and convertible pesos would be honoured, state dollar stores and agricultural markets would be maintained, and prices in state peso and dollar stores would not be raised.

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## CUBA’S ECONOMIC PROSPECTS

Although Cuba is gradually emerging from its crisis of the 1990s, this process is not without its difficulties. Policy modifications and institutional reforms made in the 1993 to 1996

period yielded important positive results, although their effects are incomplete. At the 4.2% average rate of *per capita* economic growth for 1996 to 2000, Cuba should recover its 1990 level of income by about 2005. However, some of the current sources of economic growth, namely family remittances and tourism, are vulnerable. On the other hand, improvements in oil extraction and nickel mining appear to be sustainable and may also be strengthened further.

Although in the short term the Cuban economy cannot avoid being affected by the international slowdown and the effects of September 11, in the longer term, Cuba’s economic performance will also depend on a variety of other factors. Among the positive factors are basic levels of human development, well-developed institutions in parts of the society, the backlog of innovations in the outside world awaiting implementation in Cuba, the country’s tourism potential, and the large US market.

Improved economic performance, however, will require that Cuba address a number of daunting challenges. These include expanding and diversifying exports, increasing investment levels, terminating the monetary and institutional dualism, creating an appropriate environment for self-employment and small and medium scale enterprise, and addressing other institutional and policy problems and information control. Cuba's relationship with the United States, which appears to be frozen at least until the end of the Presidency of G. W. Bush, as well as the wisdom with which a post-Castro transition is managed will also have an important bearing on Cuba's economy.

In some senses, it might be said that Cuba is in a "pre-transition" phase, similar to the situations in Hungary and Poland prior to their departure from central planning and one-party rule in the late 1980s. Cuba still has its major process of economic reform,

not to mention political reform, ahead of it. Castro will die at some time. Cuban economic policy as well as the institutional structure will likely remain paralyzed until then.

In response to the current economic slow down, and a reduction in foreign exchange earnings, Castro has assured Cuban citizens that some specific liberalizing reforms of the 1993-1995 period will not be reversed. But does this mean that the reforms he did not mention could be reversed? It seems improbable that new liberalizing reforms could be introduced, although conceivably economic realities might force some such changes. Most likely, Cuba will proceed on its current course. It will probably continue to "go it alone" and ride out the current economic difficulties, awaiting a balmier international macro-economic environment.

**TABLE 1**  
**CUBA: PRINCIPAL ECONOMIC INDICATORS: 1990–2001**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP per capita (1989 = 100.0)	96.0	86.1	77.1	66.1	66.4	67.9	72.8	74.3	75.0	79.3	83.3	85.6
GDP per capita Growth Rate (%)	-4.0	-10.3	-10.5	-14.2	+0.4	2.2	7.3	2.1	0.9	5.8	5.1	2.7
Gross Investment as % of GDP <sup>2</sup>	24.8	14.0	6.5	6.4	5.2	7.0	7.1	7.7	7.9	7.9	7.7	7.5
National Savings as % of GDP <sup>2</sup>	12.7	5.4	2.8	2.6	4.6	5.6	6.3	5.6	6.4	n.a.	n.a.	n.a.
Unemployment <sup>3</sup>	7.3	7.7	6.1	6.2	6.7	7.9	7.6	7.0	6.6	6.0	5.8	4.5
Underemployment <sup>3</sup>	10.3	19.0	24.2	34.0	32.5	32.1	26.6	25.7	25.1	n.a.	n.a.	n.a.
Sugar Harvest (million tons)	8.4	7.2	7.2	4.2	4.0	3.3	4.3	4.1	3.2	3.7	3.9	3.5
Gross External Debt \$US billions	7.0	8.0	10.0	8.8	9.1	10.5	10.5	10.1	11.2	11.1	11.0	11.1
% of Total Exports <sup>2</sup>	118	225	397	492	358	360	295	267	289	259	229	n.a.
Exchange Rate (Pesos/\$US)												
Official	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Quasi-Official	7.0	20.0	35.0	78.0	95.0	32.1	19.2	23.0	21.0	20.0	21.0	22.0- 26.0

*Sources:*

1. NU CEPAL, 2001B, pp. 13, 44.
2. NU CEPAL, 2001A, pp. 288-291.
3. NU CEPAL, 2000A, p. 253.
4. NU CEPAL, December 2001.

**TABLE 2**  
**CUBA: BALANCE OF PAYMENTS (1991–2001)**  
**\$US MILLIONS, CURRENT**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Exports:											
Total	3,563	2,522	1,968	2,542	2,926	3,707	3,873	4,085	4,288	4,807	4,893
Goods	2,980	1,779	1,137	1,381	1,507	1,866	1,819	1,512	1,456	1,692	n.a.
Services	584	742	832	1,160	1,419	1,841	2,054	2,572	2,832	3,115	n.a.
Imports											
Total	4,702	2,737	2,339	2,849	3,565	4,125	4,619	4,841	5,003	5,587	5,651
Goods	4,234	2,315	1,984	2,353	2,883	3,569	3,987	4,181	4,323	4,816	n.a.
Services	468	422	355	497	683	556	632	660	680	771	n.a.
Commercial Balance	-1,138	-215	-371	-308	-639	-419	-746	-757	-715	-780	-758
Current Transfers											
Total	18	43	263	470	646	744	792	813	828	850	750
Remittances					537	630	670	690	700	720	n.a.
Factor Services, Net	-334	-248	-264	-423	-525	-493	-483	-449	-569	-670	-750
Capital Account											
Total	1,421	419	356	262	596	174	457	409	486	640	770
of which, Foreign Investment			54	563	5	82	442	207	205	n.a.	n.a.

*Sources:*

1. NU CEPAL, 2001B, pp. 27, 35.
2. NU CEPAL, December 2001.

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*Archibald R. M. Ritter is a Professor of Economics and International Affairs at Carleton University, Ottawa, Canada. He has written on a variety of issues relating to development in a Latin American context. His works on Cuba include The Economic Development of Revolutionary Cuba: Strategy and Performance (New York: Praeger, 1974) and Cuba in the International System: Integration and Normalization, edited with J. Kirk (London: Macmillan, 1995).*

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1 Nicholas Street, Suite 720  
Ottawa, Ontario,  
K1N 7B7 Canada  
Telephone: (613) 562-0005  
Fax: (613) 562-2525  
E-mail: [focal@focal.ca](mailto:focal@focal.ca)  
Web Site: [www.focal.ca](http://www.focal.ca)

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