

**THE CUBAN ECONOMY TODAY:  
SALVATION OR DAMNATION?**

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## **INTRODUCTION**

In 2004 and the winter of 2005, the news on Cuba's domestic and external economy was both positive and negative. On the domestic positive side were an alleged growth rate of 5 percent; an unemployment rate of 1.9 percent, that is, virtually full employment; the arrival of 2 million tourists and record-breaking revenues from tourism; and the discovery of new oil wells. Equally positive on the external front were donations, credits, investments, and lucrative trade and economic agreements with China and, particularly, with Venezuela.

Conversely, on the domestic negative side were \$2 billion in losses due to hurricanes, the worst drought in the last century, the lowest sugar harvest since 1905, and the electricity crisis. External factors played ambiguous roles: the U.S. government's restrictions on travel and remittances were offset by President Fidel Castro's success in convincing U.S. exporters to lobby against the embargo and in favor of opening further their trade relations with Cuba; the reestablishment of "normal" relations with the European Union, conditioned by disagreements on human rights issues and the lack of economic aid; and the potential entry of Cuba into Mercosur, so far blocked by the nation's lack of democracy. In addition, Cuba reversed the timid economic reforms of 1993–1996 and imposed a series of drastic measures to recentralize economic decision making, ban the circulation and use of the dollar, and further reduce the small private sector. What is true, and what is myth or exaggeration about the positive news reported? To what degree would the actual positive events be offset by the negative ones? What would be the impact of reversing the economic reforms? This paper discusses all of these important issues and draws conclusions from them.

### **I. GOOD DOMESTIC NEWS**

This section discusses four officially reported Cuban economic achievements in 2004: a very high economic growth rate; a reduction of unemployment to 1.9 percent, one of the lowest rates in the world; the record arrival of 2 million tourists, yielding more than \$2 billion in revenue; and the discovery of new oil deposits.

#### **A. Strong Economic Growth**

Cuba's gross domestic product (GDP) growth steadily slowed down: 6.2 percent in 1999, 5.6 percent in 2000, 3.0 percent in 2001, and 1.5 percent in 2002, with an improvement to 2.6 percent in 2003. The annual growth rate for the decade 1990–2000 averaged (minus)-1.2 percent, the worst performance in Latin America. In 2001, Cuba's GDP at constant prices of 1981 was still 13 percent below the level of 1989 and, in per capita terms, was 18 percent below the 1989 level (Mesa-Lago and Pérez-López 2005). According to the official report, Cuba's GDP grew 5 percent in 2004 (Rodríguez 2004), slightly below the regional average of 5.5 percent (ECLAC 2004c). An intriguing question is how that growth rate was achieved despite significant losses due to two hurricanes, the worst drought in a century, a poor sugar harvest, an electricity crisis that shot down several industries (see sections III-A, III-B, and III-C of this paper), and high oil prices, as well

as declines in foreign direct investment (FDI), capital formation, travel of Americans to Cuba, and possibly of remittances—the last two results of tightening by the Bush administration.

The UN Economic Commission for Latin America and the Caribbean (ECLAC) estimated (2004a; 2004c) Cuba's growth rate in 2004 at 3 percent, although it did not publish the inflation rate, hence raising the question on how GDP at constant prices was calculated. *The Economist* also estimated a 3 percent GDP growth rate in 2004 ("With Help ..." 2005). How can a difference of 2 percentage points between the Cuban and the external figures be explained? And how was Cuba, despite all its grave economic difficulties, able to surpass by almost twice, its growth target of 2.6 percent set for 2004?

The official rate is bogus due to several reasons: (1) the shift in the calculation of GDP in constant prices from its previous 1981 base to a 1997 base starting in 2001 resulted in an increase of 60 percent in the value of GDP in each year of the period 1996–2000 (the five years for which both series are available); (2) in 2001, Fidel Castro, Minister of Economics and Planning José Luis Rodríguez, and other economic authorities began to criticize the international methodology to estimate GDP, and Castro (2002) said, "GDP tells us very little. What purchasing power has a salary in light of social policies. . . . All are lies and distortions."; (3) in 2002, Minister Rodríguez used the purchasing power parity of the peso, compared with other currencies to buy a given basket of goods, to calculate a GDP that was 109 percent higher than using conventional exchange rates; (4) in 2003, Rodríguez gave two figures of GDP growth: one based on the international methodology was 2.6 percent; another adding the value of free social services and consumption subsidies to the population was 3.8 percent (for details see Mesa-Lago and Pérez-López 2005).

A Cuban economist who asked to remain anonymous explained how some of the calculations were done to estimate the value of free social services: "We performed a given number of heart surgeries; how much they would cost if prices in foreign countries had being used? We offered an English course on television; how much would have cost if it had been sold in cassettes in a given foreign country? . . . The result is that we don't know the real situation of the Cuban economy." A diplomat who lives in Havana said, "The Cubans have the right to make those calculations, but if they want to be compared with the rest of the world, they must apply the accepted international methodology or at least publish two figures" (Arreola 2005).

In my opinion, the two GDP growth rates available for 2004 reflect the dual calculation explained above: the 3 percent rate given by ECLAC and *The Economist* is possibly based on the conventional methodology, while the 5 percent rate given by Cuba is inflated to add the value of free social services and price subsidies. Significantly, if the overestimation of GDP annually detected in the period 1996–2000, due to the shift in the base year, still continues, the 3 percent rate is 60 percent inflated and once adjusted would be reduced to 1.2 percent. The reason that Cuban officials are doing all these statistical manipulations is to show that the declining rates in 1999–2002 have been reversed and the new Cuban centralization policies are generating an economic recovery

instead of stagnation or decline. At the end of 2004, Minister Rodríguez (2004) declared to the National Assembly that the “new method” invented by the Cubans “still reflects only part of the social services provided in our country [hence] these calculations will continue to improve, steadily raising their precision and quality.” One could add: and artificially raising the GDP, too.

## **B. Full Employment**

In 2002, Castro declared, in an international meeting of economists, “The category of unemployed must disappear. There will be no more unemployment. . . . We have promised a guaranteed job to all the youth. Unemployment at the end of this year will be between 3 percent and 3.5 percent” (2002). The rate was officially given as 3.3 percent of the labor force at the end of 2002, and a new decline to 2.3 percent was reported in 2003. According to Minister Rodríguez (2004), open unemployment in Cuba further decreased to 1.9 percent in 2004, tantamount to full employment. ECLAC (2004c) gave a rate of 2 percent, still the lowest in Latin America and the Caribbean, and one of the lowest in the world. The Cuban official unemployment rate has steadily declined from 7.9 percent in 1995, despite the fact that in that year the Cuban Confederation of Workers (CTC) estimated that there were from 500,000 to 800,000 unneeded workers in the state sector, a surplus miraculously cut by 97 percent in 1997. Furthermore, after a modest expansion, the private sector that could generate new jobs has contracted since 2002; 219,000 sugar workers were dismissed in that year due to the restructuring of the sugar industry (Mesa-Lago and Pérez-López 2005).

An independent Cuban journalist cites reductions in jobs or time of work that made that feat even more amazing: the electricity crisis of 2004 led to the shutting of 107 industries and a number of hotels; the 2004–2005 sugar harvest was delayed from December to January, and only 56 sugar mills operated (23 less than in 2004); to save electricity, the working day was reduced by 2.5 hours per week from October 25, 2004, to February 28, 2005, and the number of self-employed workers shrank by 43 percent in 1997–2003. According to the journalist, the miracle is accomplished with unemployment figures elaborated upon by the Ministry of Labor and Social Security (MTSS), based on reports from municipal offices on persons requesting employment. However, very few people do this because once they are identified as searching for a job, they come under enormous pressure from the MTSS, the municipal offices, and the Committees for the Defense of the Revolution to work in agriculture. Instead, they just go into the informal economy (Brito 2005). The same explanation was given by Cuban independent economist Ramos Lauzurique (2003).

Significant contradictions in official data on employment and unemployment are analyzed elsewhere. Suffice it to say here that, in 2002, the government counted as “employed” 764,000 people who (1) were paid to study, (2) were dismissed from their jobs and being retrained, (3) received unemployment compensation at home because of shut down enterprises, or (4) worked part time in backyards and urban gardens. All these people equaled 16 percent of the labor force, and, because they are counted as employed, the unemployment rate was artificially cut (Mesa-Lago 2005a).

### **C. Record-Breaking Tourist Arrivals and Revenue**

The number of foreign tourists rose from 270,000 in 1989 to 1.77 million in 2000, but tourism stagnated in 2001, and the number declined to 1.69 million in 2002 because of the September 11, 2001 terrorist attacks. Then it rose to 1.9 million in 2003. Gross revenue from tourism increased from US\$1.1 billion in 1995 to \$1.9 billion in 1999, stagnated for three years, declined to \$1.7 billion in 2002, and recovered to \$2 billion in 2003. The government announced the record 2.05 million tourists with gross revenue of \$2.25 billion in 2004 as a great victory. Targets set for 2005 are 2.29 million tourists and a “higher” gross revenue (Rodríguez 2004).

The tourism achievement in 2004 should be tempered with several caveats. During the five-year period from 1994 through 1999, the number of tourists rose at an annual rate of 24.8 percent, and gross revenue rose at an annual rate of 33.2 percent. In contrast, during the five-year period from 2000 through 2004, the annual rates of growth slowed down to 3.1 percent for number of tourists and 3.2 percent for gross revenue. It is true that the island had a relatively low number of tourists and low gross revenue in 1994; it is also true that reactions to the September 11, 2001 events slowed down growth for the past five years—yet, Cuban growth rates compared with other countries in the Caribbean are still quite low.

Second, participants in the Fifth Party Congress set a target of 2 million tourists for 1998–2002, which was unfulfilled by 16 percent, and a target of \$2.6 billion gross revenue from tourism, which was not met by 31 percent. The target of 2 million tourists was set again for 2001, with a more modest \$2.2 billion in revenue, and both were unfulfilled by 10 percent and 18 percent; in the following two years, both targets were significantly reduced and barely met. It eventually took Cuba seven years to reach the number of 2 million tourists, but the goal of \$2.6 billion in revenue still had not been met by 2004.

Third, revenue figures are gross, and no systematic data are available on the value of imported hard currency inputs to cater to foreign tourists—necessary to calculate net revenue from tourism. The few available figures are contradictory, ranging from 35 percent to 65 percent; gross revenue, therefore, must be adjusted down by that factor. A Cuban scholar has argued that the nation must produce domestically a larger share of the inputs required by the tourism industry or the sector will demand imports valued at \$3 billion per annum, roughly the magnitude of the annual overall merchandise trade deficit from 2001 to 2003. Until Cuba is capable of providing its needed inputs domestically, the multiplying effect of the tourist industry will not take place.

Fourth, the occupancy rate of hotel rooms for international tourists declined from 78 percent in 1997 to 69 percent in 2001 and to 50 percent in 2002. Average expenditures, average length of overnight stays at hotels, and average receipts per visitor have all declined since the mid-1990s (Mesa-Lago and Pérez-López 2005).

### **D. The Discovery of New Oil Deposits**

As a result of foreign investment, crude oil production in Cuba steadily increased: from 1.4 million tons in 1997 to 3.69 million tons in 2003, more than five times the output level of 1989 (a decline was officially reported in 2004 without providing a figure). Until December 2004, all the oil that had been discovered and was produced in Cuba was of bad quality (heavy with high sulfur content), making it unsuitable for export and only usable for domestic consumption. The latter use, however, damaged thermoelectric plants, forcing costly maintenance and repairs, and the failure to do so provoked the breakdown of the Antonio Guiteras plant in 2004 and subsequent electricity crisis. In the summer of 2004, many had high hopes of a significant high-quality oil discovery in an offshore area about 30 kilometers northeast of Havana in the Gulf of Mexico. Spanish oil company Repsol YPF, which had been awarded the right to explore in that area, leased a Norwegian exploration platform, at a cost of \$195,000 per day, to carry out the deep water exploration. Frustrating that hope, in August 2004, Repsol YPF confirmed the existence of high-quality oil but explained that the deposit was considered noncommercial, because of insufficient quantities to justify exploration and production expenditures. Nevertheless, the Spanish firm kept drilling a 4,132 square mile track, hoping for best results (Mesa-Lago and Pérez-López 2005).

In December 2004, Castro announced to the National Assembly that the association Sherritt-Pebeco had found a “very promising” deposit in Santa Cruz, in an offshore area 55 km east of Havana (close to the Repsol YPF site) that had extracted 1,000 tons of crude between December 14 and 19. The baptized “Santa Cruz 100” well was preliminarily estimated to have a deposit of 20 square km of crude “of 18 degree API, lighter than the crude from Varadero and Yumurí [deposits already in exploitation], and with less than 5 percent of sulfur content [although] it has to be mixed in a proportion of 20 percent with crude lighter and with less sulfur content.” The Santa Cruz 100 well was closed to “investigate its characteristics” and will be reopened and maintained in “experimental production for several months [including perforation of two evaluation wells east and west of Santa Cruz 100 in the first semester of 2005], with the purpose of observing its behavior and determine more precisely the parameters of the deposit.” And yet, “a preliminary estimate of the extractable reserves of the deposit indicates a minimum of 100 million barrels, approximately 14 million tons.” If the deposit size and characteristics of the crude are confirmed, a “stage of development” will take place in 2006–2007; three other wells would also be drilled in Tarará, Guanabo, and Jibacoa, which are expected to have the same features of the Santa Cruz deposit (Castro 2004b).

This recent oil discovery certainly is good news for the dismal Cuban economy, but some caveats are in order. First, there are questions about the accuracy of a “preliminary estimate” of the size of the deposit, based on six days of extraction of 1,000 barrels and taking into account that an experimental production of six months is needed to determine more precisely the parameters of such a deposit.

Second, the issue of the quality of the oil discovered and the fact that it has to be mixed with better quality crude must be considered. Castro’s full speech to the National Assembly was not published, only a summary of its good news. A Cuban independent

journalist reported that Castro said the crude was “semi heavy” (Sánchez 2004), while *The Economist* stated that it is “a small field” and the “oil is heavy” (“Cuba’s Economy...” 2005).

Third, if indeed the deposit contains 14 million tons of crude, it would supply Cuba’s total oil need for 18 months. At its peak in 1985, Soviet crude delivery for that one year was 8 million tons, tantamount to 57 percent of the preliminary estimated size of the whole Santa Cruz deposit (Mesa-Lago 2000). Notably, since the announcement of the discovery was made, no news has been published on the progress of the experimental production in the first semester of 2005.

## **II. GOOD NEWS ON THE EXTERNAL FRONT**

Two significant positive external events have aided Cuba economically and may even help more in the future: the trade agreements with Venezuela and China.

### **A. Agreements with Venezuela**

With Venezuela’s President Hugo Chávez’s favorable disposition toward Cuba, the country has truly enjoyed a bonanza, due to the highly beneficial five-year trade agreement signed in October 2000 (renewable for other five years) with Venezuela’s state oil corporation PDVSA to deliver to the island 53,000 barrels of oil daily, equivalent to 2.7 million tons of oil per annum, supplying about 30 percent of domestic needs, under the following terms: 80 percent of imports are payable in 90 days at prevailing world market prices, while the remaining 20 percent are payable in 5 to 20 years at the average annual oil price, but up to one-fifth of the 20 percent can be paid through medical, educational, and sports services. This agreement has partially protected Cuba from record world market petroleum prices. It is estimated that over the five years of the agreement, Cuba will receive about \$2.6 billion in oil and in proceeds from reselling some of the oil. Cuban brokers in cooperation with PDVSA have already resold a portion of the Venezuelan oil at market prices, earning a juicy profit for Cuba. Despite those beneficial conditions, at the end of 2001, Cuba had a debt of \$95 million for unpaid oil deliveries, and PDVSA suspended shipments in April 2002, an action that led Chávez to dismiss the president of that corporation.

The brief overthrow of Chávez resulted in irregular deliveries, but normal shipments were resumed in September 2002, after Cuba agreed to restructure its oil debt, which by then had grown to \$142 million. The general strike in Venezuela from December 2002 to January 2003 led to new delivery interruptions and widespread blackouts in Havana. In March 2003, the general auditor of Venezuela estimated the Cuban oil debt at \$266 million; later another estimate set such debt for 2001–2003 at \$752 million, tantamount to 80 percent of the total debt owed PDVSA by its foreign clients. In 2004, PDVSA reportedly increased deliveries to Cuba from 53,000 to 78,000 barrels per day (from 2.7 million tons to 4 million tons per annum). Cuba’s cumulative oil debt to Venezuela projected for 2004 was \$992 million. The Venezuelan government claimed that Cuba had honored the terms of the agreement, and Cuba’s Ministry of

Foreign Trade ratified this statement, adding that Cuba was not in arrears (Mesa-Lago and Pérez-López 2005). Cuba's output of crude oil decreased in 2004, aggravating the need for imports (Rodríguez 2004).

A second bonanza, greater than the first, occurred on December 14, 2004, when Cuba and Venezuela signed new, wider economic and trade agreements with the following terms: (1) economic integration of both countries, including the opening of banks in each and reciprocal banking credit contracts to facilitate payments in financial and commercial transactions; (2a) in both countries elimination of trade tariffs, (b) exemption of tax on profits from investment in state and mixed enterprises (also private enterprises in Venezuela) during the period of investment recovery, with air and shipping lines receiving the same treatment (Venezuela provides Cuba with infrastructure and equipment related to air and maritime transportation), and (c) Venezuela may have 100 percent ownership of its investments in Cuba (an exceptional concession, as Cuba usually keeps 51 percent of ownership in all foreign investment); (3) the price of oil will continue as in the first agreement, but Cuba guarantees to pay a minimum of \$27 per barrel (about one-half the current world price), and Venezuela will increase oil supplies in 2005 to meet all Cuba's needs in excess of domestic production ; (4) the tens of thousands of Cuban physicians, nurses, teachers, and sport trainers working in Venezuela will train people there, and their salaries will now be paid by Venezuela (before this agreement such salaries were paid by Cuba as a way to reimburse Venezuela for part of the oil received); (5) Cuba will provide 2,000 annual higher education fellowships to Venezuelans, while Venezuela will transfer technology on energy and award Cubans all the needed fellowships in this field; (6) Venezuela will finance Cuban projects in agriculture and industry, infrastructure, energy, paving of streets, construction of aqueducts and sewage treatment facilities; and (7) negotiations are on the way for additional agreements on the following: Venezuela would supply 590,000 tons of coal annually for the ferronickel plant with China; a joint enterprise to produce stainless steel would be established by Cuba, China, and Venezuela; Canada's Sherritt International Co. and Venezuela would built a coal thermoelectric plant in Mariel; and PDVSA would buy part of the oil refinery in Cienfuegos unfinished by the Soviet Union ("Acuerdos..." 2004; "Castro 2004b).

In February 2004, it was confirmed that Venezuela was supplying Cuba with 78,000 barrels of crude oil of top quality and oil derivatives daily (rather than the 53,000 of the first agreement), with an average value of \$1 billion annually. Only part of that oil was actually delivered to the island; most of it is negotiated by PDVSA and Cuban brokers and sold to El Salvador, Guatemala, Honduras, Nicaragua, and Panama, with dollar earnings transferred to Cuba. It was also estimated that Cuba's oil debt with Venezuela had reached \$2.5 billion before the end of the five-year agreement in October 2005 (Ocando 2005).

Venezuela is rapidly approaching the amount of virtually free aid that the Soviet Union provided Cuba in the 1980s, before the downfall of socialism: (1) at 78,000 daily barrels delivered to Cuba in 2005 (4 million tons), Venezuela is supplying at least 44 percent of Cuba's oil needs; (2) as of the end of 2004, Cuba is expected to pay \$27 per oil

barrel, less than half the current world market price, which will result in a subsidy of \$800 million in 2005, similar to that granted by the USSR at the peak of the oil price subsidies from 1975 to 1982 (Mesa-Lago 2000); (3) but Cuba is not actually paying for all oil deliveries, as the unpaid debt averaged \$600 million annually from 2000 through 2004, a sum that will surpass \$2.5 billion in 2005; (4) like the USSR in previous years, Venezuela is transferring millions of dollars to Cuba for the value of undelivered oil that is sold to third countries; (5) Venezuela is paying the salaries of tens of thousands of Cuban personnel working there, even though Cuba was expected to pay such salaries according to the oil agreement of 2000; (6) the 2004 agreement commits Venezuela to provide millions of dollars to finance Cuban projects in agriculture, industry, energy, paving of streets, and water and sewage infrastructure (badly in disrepair in Cuba), without published specifications on amounts, interest, and repayment of principal; and (7) if current negotiations between the two countries are successful, Venezuela will invest hundreds of millions of dollars more to supply coal for the Chinese nickel plant (hence compensating Cuba and China for the high cost of nickel extraction, see section below), stainless steel production, and an oil refinery.

## **B. Agreements with China**

Due to political divergences in the past and their two significantly diverse economic models (market socialism in China and centralized command socialism in Cuba), the two countries have been at odds many times. Despite their differences, in 2003 China was Cuba's fourth trade partner, with 7 percent of total transactions, after 14 percent with Venezuela, 13 percent with Spain, and 8 percent with Canada. In addition, China provided credits from 1990 through 1994 for imports and construction of a factory to build bicycles and fans, as well as imports of pharmaceutical products and equipment. About 61 percent of Cuba's total exports to China are nickel (an important raw material needed in China's booming economy); the rest are sugar, tobacco, fish and seafood, and rum (*Juventud Rebelde*, December 21, 2004). In 2004, an Entrepreneurial Committee was established by the two countries, and 37 representatives of China's large enterprises visited Cuba to discuss projects on electronics, telecommunications, biotechnology, and pharmaceuticals (Musa 2004).

In November 2004, as part of his tour of several countries in Latin America, Chinese President Hu Jintao went to Havana, met with Fidel and Raúl Castro, and signed several beneficial trade and aid agreements, including the following: (1) a deferral for 10 years of the payment of Cuba's financial obligations to China accrued from 1990 through 1994, estimated at about \$37.8 million; (2) a donation of \$6.1 million to purchase Chinese textiles; (3) a credit of \$6.1 million to be paid in 15 years with a grace period without interest in the first five years, to buy materials and spare parts for hospitals, clinics, and dental and optical units (the combined value of the first three agreements was officially reported as \$50 million); (4) a credit to buy one million TV sets in China to be paid in 8 years with a 2-year grace period at 5.89 percent interest (the amount of this credit is undisclosed but might be about \$150 million); (5) a credit of \$500 million from Chinese banks toward the creation of a mixed enterprise (51 percent Cuban and 49 percent Chinese) to resume construction of the ferronickel plant left unfinished by the

USSR [and other Eastern European countries; this is most likely the Camariocas plant], with a capacity to produce approximately 22,500 tons of nickel [per year] for a period of 25 years; the loan shall be paid in 15 years with a grace period during construction (Cuba will export to China 4,000 tons of nickel annually from 2005 through 2009 at undisclosed prices); (6) studies will be started to establish a mixed enterprise (51 percent Cuban and 49 percent Chinese) in a new nickel deposit in San Felipe, Camagüey, which would produce 50,000 tons annually, with an investment of \$1.3 billion provided by Chinese banks; (7) an oil exploration contract with China's Petroleum and Chemical Corporation (SINOPEC), although Castro has warned that the Chinese do not have experience in exploration in deep waters; (8) other potential credits are under discussion for refurbishing and modernizing Cuban hospitals for domestic and foreign patients and infrastructure works such as ports, railroads, ships, and oil and nickel equipment, and (9) the building of a Chinese hotel in Cuba, although few Chinese tourists currently come to the island (Castro 2004b).

The most important of these agreements are those related to nickel exploration and extraction. If the Chinese investment in this industry materializes, the combined production of the unfinished plant and the new one would be 72,000 tons annually, thus almost doubling current nickel output of 77,000 tons. This would result in a significant expansion of the installed capacity, contrasted with Canadian investment in that industry that, until the end of 2004, basically concentrated in refurbishing installed capacity in the Nicaro and Moa plants built by the United States in the 1940s and 1957 respectively. It is not clear from Cuban reports, however, what the time span will be to get the two plants in operation, and there is a crucial question about their technology. The Soviet-built Che Guevara plant in Punta Gorda copied Nicaro's antiquated, energy intensive technology (it consumes 18 tons of oil for each ton of nickel produced, contrasted with a ratio of 5 tons of oil to 1 ton of nickel in the more modern Moa plant), which was extremely costly after the cheap, unpaid Soviet oil ceased to arrive in Cuba and world market oil prices spiraled. The Che Guevara plant was shut down in 1990 due to oil scarcity and reopened later, but its output is smaller than in the other two plants. Construction of the Camariocas plant, also located in Moa, was started in 1984 by the Soviet Union and five Eastern European countries but was never completed. Cuban efforts with foreign partners tended to be unsuccessful; this plant used the same outdated technology of the Che Guevara plant (Mesa-Lago 2000). If China is indeed planning to invest \$500 million to complete the Camariocas plant using the older technology, costs would be very high, forcing the Chinese to subsidize nickel prices as the Soviets did before.

In December 2004, Castro reported an agreement under discussion with Sherritt International for a \$1 billion investment to expand the installed capacity of the Moa plant and increase its output by 53,000 tons annually, from 32,000 to 85,000 tons. He added that, combined with the Chinese investment in the new plant, nickel output will double (Castro 2004b). In March 2005, it was reported, however, that the agreement actually signed was to invest \$450 million (50 percent Sherritt and 50 percent Cuba) in the existing Moa plant to increase output by only 16,000 tons annually ("El Gobierno..." 2005). The combined expected results of the Chinese committed credit and Sherritt

investment would be an increase of 38,500 tons of nickel in the next 10 to 25 years, 50 percent more than current output of 77,000 tons.

Do these beneficial agreements mean that China supports Cuba's state centralized economic model? The answer is a resounding "no," according to a document from the Institute of Latin American Studies of the China Academy of Sciences, published before the recentralization process was accelerated in Cuba. It compares the economic success of China, based on a vigorous market-oriented reform since 1978, with Cuba's stagnation, resulting from timid reforms, and offers some important lessons to the Cuban leadership: openly embrace and speed up the pace of economic reforms; be more liberal in ownership restructuring (for example, privatize agriculture and state enterprises in industry and other sectors); take a more tolerant attitude toward the nonstate sector; and stimulate people's initiative and allow some to become rich in order to promote economic growth (IELA 2002). China's concessions to Cuba are relatively small compared with investment and trade pacts signed by President Hu Jintao in the fall of 2004 with several countries in Latin America. China is taking a pragmatic attitude, that is, to obtain needed nickel from Cuba, as well as to show the Chinese Communist Party and leftists around the world that it helps Cuba vis-à-vis the Colossus of the North.

### **III. THE BAD DOMESTIC NEWS**

This section summarizes four major domestic upsets: two hurricanes in 2004 and the worst drought in a century, the virtual demise of the sugar industry, and the electricity crisis.

#### **A. Two Hurricanes and the Worst Drought in the Last Century**

In the three years from November 2001 to November 2004, Cuba was hit by five hurricanes: Michele (2001), Isidore and Lili (2002), and Charley and Ivan (2004). The last two hurricanes caused \$2.15 billion in damage: 54,325 hectares of crops were damaged; 2.4 million animals had to be moved, which also affected production particularly of pigs and poultry (800,000 chickens died); 5,360 dwellings were destroyed, and 94,896 were damaged (Rodríguez 2004).

For more than two years, Cuba has been suffering from severe drought throughout the island, now considered by Cuban authorities the worst in 103 years. In 2004, the average rainfall was 69 percent of the normal average, and, by February 2005, it had decreased to 58 percent of the normal average (27 percent in the eastern provinces). According to Cuba's Institute of Hydraulic Resources, in March 2005, the 235 existing dams were at only 32 percent capacity; out of 73 dams used for water supply of the population, 15 had exhausted their reserves, and another 23 would be without water in less than three months. March is one of the months with less rain and, if the bad luck continues, there will be no relief until April or May. It is estimated that 4,000 km of aqueducts (equivalent to 37 percent of all national networks of water supply) are in bad shape, and the cost of repairs would be above 120 million convertible pesos. Close to 2 million people suffer from lack of water, mostly in the City of Havana, Las Tunas,

Camagüey, and Holguín; 700,000 of them have to be supplied with water trucks. The government is imposing tough conservation measures, but half of the water in Havana homes is lost due to pipe and faucet leaks, and large enterprises consume 2 to 6 times more water than they need (“Casi Dos...” 2005; EFE 2005b; *Juventud Rebelde*, March 11, 2005). The losses due to drought in the last two years were estimated at the end of 2004 as \$834 million, including 127,600 cattle dead, 53 million liters of milk, 220,000 tons of tubers, 40,000 tons of tomatoes, and 28,160 hectares of other crops lost and 39,972 hectares damaged (Rodríguez 2004).

Cuban authorities blamed, to some extent, the combination of hurricanes and a drought for the results of their disastrous agricultural policies. In 2003, there were no hurricanes, but outputs of eight key agricultural products were significantly below 1989 levels: sugar (minus) -73 percent, beef -54 percent, rice -49 percent, coffee -48 percent, milk -46 percent, tobacco leaf -36 percent, eggs -33 percent, and citrus -20 percent. The agricultural cooperatives (basic units of cooperative production—UBPCs) are not truly independent because the state largely determines what they produce and buys virtually all their output at prices set below the market price. Hence, the workers lack incentives, and a good part of the cooperatives have losses. As a result, the UBPCs control 58 percent of total cultivated land, but their share of sales in the free agricultural markets is only 4 percent; in contrast, private farmers, who control only 17 percent of cultivated land, are able to sell their output at market prices much higher than the prices paid by the state and account for 73 percent of the sales in the free agricultural markets (Mesa-Lago and Pérez-López 2005).

## **B. The Worst Sugar Harvest in One Hundred Years**

In the period from 1994 through 2003, annual sugar output averaged 3.7 million tons, less than half the average production of the 1980s. Sugar production from the 2002–2003 harvest was 2.2 million tons (the lowest since 1933, when 2 million tons were produced) and 2.5 million tons in 2003–2004 (70 percent below the level of 1989). Causes of such dismal performance were the following: the sugarcane area harvested decreased by 33 percent and sugarcane lands under irrigation by about 40 percent; weeds expanded to cover as much as 15 percent of the cultivated area; sugarcane yields fell by 46 percent; and the industrial yield steadily decreased from 12.5 percent in the years from 1961 through 1965 to 10.1 percent in 2002. Lack of incentives was the underlying reason for such a debacle (Mesa-Lago and Pérez-López 2005). In 2003, 45 percent of the sugar mills were shut down, and the sugarcane cultivated land was reduced by 65 percent, from 2.2 million hectares to 765,000 hectares, because of low industry efficiency combined with low world sugar prices. According to the Ministry of Sugar (MINAZ), the peso cost of producing one peso per ton of sugar increased from 0.90 in 1993–1994 to 1.92 in 1997–1998, then declined to 1.16 but rose to 1.29 in 2002–2003; only in one harvest (1992–1993) was the cost below one peso (cited by Delgado 2005).

The 2004–2005 harvest was delayed from the usual start at the beginning of December to January, lasting four instead of five months. Out of the 79 sugar mills that operated in the previous harvest, only 56 functioned in the 2004–2005 harvest (one-third

of the total number at the end of 2002), and six of them did not start until February. The drought particularly affected sugarcane plantations in Camagüey, Las Tunas, and Holguín, which produced one-third of the crop in 2003–2004; Pinar del Río, Villa Clara, and Ciego de Avila provinces, also important sugarcane producers, were also afflicted (“Eficiencia...” 2004). The lack of rain led to very small and thin stacks with low sugar content. But a high official of the MINAZ reported in March 2005 that the lack of sugarcane and frequently broken equipment (that provoked loss of time) were the main problems of the harvest, rather than the drought (AFP 2005; EFE 2005a; Varela 2005). In mid-March 2005, Castro and other Cuban officials estimated that the harvest would be only 1.5 to 1.7 million tons (the worst since 1905 with 1.3 million tons). Castro said, “Sugar belongs to slavery times and will never come back to this country” (AFP 2005; Castro 2005d).

The significant decline in sugar production in 2004–2005 will be the final blow to the sugar industry and will create serious problems as Cuba struggles to meet domestic needs (700,000 tons) and external commitments. In December 2004, Cuba bought 15,000 tons of sugar from Colombia and another 7,000 in February 2005. The world price of sugar is rising due to the extremely low Cuban harvest and problems faced by other large producers such as India, but Cuba will not be able to take full advantage of such high prices because a considerable part of the sugar produced has been already committed for export at prices lower than current world market prices.

### **C. The Electricity Crisis**

In May 2004, the Antonio Guterres thermoelectric plant in Matanzas, one of the country’s major power generation plants, was temporarily shut down, reportedly for routine maintenance, and was slow to return to operation. A problem confronted by this and other plants is the use of domestically produced heavy oil with a high sulfur content. The overtaxed electric generation system was unable to cope with demands, and electricity blackouts rapidly multiplied, lasting as long as six to eight hours per day in some areas. To confront the severe lack of electricity, starting in August 2004, the government took the following measures: (1) shutting down of nonessential activities of state enterprises; (2) granting of paid leave to nonessential workers; (3) eliminating air-conditioning in state offices during peak demand hours and turning off lights early at night; (5) scheduling of irrigation activities during evening and dawn hours; (6) closing 4,000 hotel rooms in La Habana, Varadero, Cayo Largo del Sur, Las Tunas, Trinidad, and Santiago; (7) shutting down 188 factories during October, including the largest steel mill (for 220 days), sugar mills, paper producers, and citrus processing plants; and (8) reducing the length of the workday by 30 minutes (three hours weekly) for four months, which ended on February 28, 2005 (Mesa-Lago and Pérez-López 2005).

The electricity crisis cost more than 200 million pesos. The government did not report overall industrial output at the end of 2004 but acknowledged that it “was affected.” Output decreased or was stagnant in 12 out of the 20 industrial lines, the generation of electricity declined by 1.4 percent, and 120,000 tons of steel were lost—problems that forced the importation of many goods (Rodríguez 2004). Minister of Basic Industry Marcos Portal, a relative of the Castro family who had held that post since the

early 1980s and was considered one of the country's top leaders, lost his job because of the electricity crisis. In October, he was blamed for character flaws and errors in judgment, including a failure to alert the top leadership of the party and the government of "the risks associated with a crisis that could have been prevented . . . and has forced the nation to undertake urgent and costly measures. . ." ("Nota ..." 2004).

In March 2005, Castro publicly answered two among 26,000 opinions collected in reaction to his announcement that 100,000 pressure cookers would be sold to the population (the price of the cooker, "a gift from the Commander in Chief," is 150 pesos, tantamount to 55 percent of the average monthly salary). The first question was whether cookers would not increase electricity consumption in the midst of conservation measures. He responded that a government study had shown that energy savings in the use of kerosene would be greater than the electricity used by the cookers. The second question was how the people were going to use the cookers with constant electricity blackouts. Conceding that this was a good question, Castro promised that by the second quarter of 2006 the installed capacity for electricity generation will be so great that there will be no risks of shortages, unless incidents occur such as the U.S. invasion of Cuba or Venezuela or the assassination of President Chávez, but he warned that no illusions should be harbored. He also asserted that electricity rates would not be increased in the future "except to the self-employed and similar enterprises that consume more than the average family" (Castro 2005c; 2005d).

#### **IV. BAD OR GOOD EXTERNAL NEWS?**

This section analyzes three external events that have unambiguous results: the new U.S. government restrictions on travel and remittances to the island versus an opening of the embargo that has allowed Cuba to become the third largest U.S. food importer within Latin America; the reestablishment of normal relations with the European Union, tied to a "fortified" relationship with the dissidents and apparently a halting of economic aid; and the potential entry of Cuba into Mercosur facilitated by the new Uruguayan government but blocked by the island's lack of democratic institutions.

##### **A. U.S. Government Restrictions vis-à-vis Openings in the Embargo**

###### *1. The Restrictions: Adverse Effects Not on the Government but on the People*

In June 2004, the U.S. government enacted a series of restrictive measures regarding travel to Cuba and sending remittances and parcels, supposedly intended to cut resources and weaken the Castro regime, as follows: (1) family visits are restricted to one per year for a maximum of 14 days and permitted only for visits to immediate relatives; (2) a maximum of 44 pounds of baggage is allowed to visitors, the daily allowance per person for dollars to cover food and lodging was cut from \$164 to \$50, and the previously permitted imports of US\$100 in currency per visitor have been abolished; (3) remittances may be sent only to the immediate family (the \$1,200 annual limit was not changed by these measures); and (4) gifts and parcels are restricted both in frequency and commodities authorized (U.S. Department of Commerce 2004). In addition, the United States

tightened travel to Cuba masked as educational or religious. There is evidence that such policies have not significantly harmed the Cuban government but have made life even more difficult for the people, while the embargo has been significantly eroded by the opening of food and medicine exports from the United States to the island.

In the last 44 years, the U.S. embargo has failed to overthrow the Castro government. Nor will the restrictions enacted by the Bush administration be successful either in weakening Castro or the Cuban economy. For starters, the estimate of about \$1 billion in foreign remittances sent to Cuba annually has been exaggerated: one scholarly study based on the U.S. census and a recent survey conducted by Florida International University indicates that they do not surpass \$400 million per year (see details and sources in Mesa-Lago and Pérez-López 2005). Due to the travel restrictions, the number of U.S.-Cuba flights decreased from 118,938 from July through December 2003 to 50,558 from July through December 2004, and the numbers of Americans going to the island decreased between 50 percent and 70 percent. (Among Cuban Americans, the decrease is reported only as 38 percent, despite the official limitation of trips from three to one per year, suggesting that this group is circumventing the law by traveling through third countries.) And yet, U.S. citizens constitute only 4 percent of total visitors to Cuba; half are from Canada and most of the rest from Italy, the United Kingdom, and Spain. We have seen that in 2004 a record 2 million tourists visited the island and generated more than \$2 billion in gross revenue; a 12 percent increase is forecast for 2005. There is no information on whether the maximum amounts of currency allowed to those who travel to the island—that would have required careful checking of each passenger—have been enforced. Controlling for remittances being received only by immediate relatives probably has failed because it would have required that agencies doing the transfer check the relationship of recipients with the donor. Actually, money can be sent to an immediate family member who, in turn, passes it to non-immediate relatives. It is equally impossible to guarantee that travelers do not spend more than \$50 daily unless visitors are followed to ensure that they do not spend more than that sum.

The U.S. restrictions have had adverse effects not on the Cuban government but on the people on both sides of the ocean, stimulating illegal travel, increasing its costs, and obstructing but not impeding visits. In the meantime, Castro and the top leadership have not been affected in the least by the new measures, as they continue to enjoy good food, access to medicines, and privileged health care in the armed forces' hospitals. Instead of unleashing aggressive countermeasures against Washington (like a massive boat exodus), Castro took advantage of the restrictions to justify an increase from 10 percent to 35 percent in prices of goods sold at hard currency shops (Tiendas de Recuperación de Divisas—TRD) in Cuba, hence tightening one more hole in people's belts. Apparently, he does not fear that hunger will incite rebellion. Furthermore, Castro has blamed the U.S. administration for the island's abysmal economic performance. Allowing Cuban Americans to visit Cuba and to send remittances and packages of food and medicine to their relatives and friends there were the most effective actions undertaken by the U.S. government to reduce the Cuban people's animosity toward the United States, which then started the needed reconciliation and fomentation of civil society values and actions on the island. Those humanitarian and family ties have done

more to erode the Castro regime than 44 years of the U.S. embargo, but the recent restrictions may have revived resentment within the people toward the United States and Cuban exiles.

## *2. The More Flexible U.S Embargo*

In contrast with the above restrictions, in 2000 the U.S. Congress approved an act that modified the trade embargo, allowing direct exports to Cuba of food and small amounts of medicine, provided they were paid for in cash. Initially, the Cuban government rejected that opening because it wanted to buy on credit but changed its stance after the agricultural losses caused by Hurricane Michelle and with a clever strategy to soften the embargo. From the end of 2001 to February 2005, U.S. merchants and farmers sold Cuba \$1.26 billion in agricultural products, making the United States the number-one supplier of such products to the island and Cuba the third largest U.S. food importer within Latin America. In 2004, at the same time the Bush administration's restrictions were imposed, such sales increased by 25 percent and reached a record \$392 million; by February 2005, \$340 million had already been contracted ("Declaración..." 2005; Cancio 2005).

In 2004, three important actions took place that expanded trade and other business between the United States and Cuba: (1) the U.S. Senate Appropriation Subcommittee on Agriculture voted unanimously to approve a bill making it easier for U.S. companies to market agricultural and medical goods to Cuba by removing case-by-case license requirements and allowing a general license, under the argument that the current restrictions are not hurting Castro but U.S. farmers; (2) the House of Representatives approved two proposals to facilitate trade and student travel to the island without scrutiny, although it rejected a proposal to "weaken the embargo"; and (3) for the first time, the U.S. Department of the Treasury granted authorization to an American corporation in San Diego to license the technology for development of a package of three anti-cancer vaccines, developed by the state Center for Molecular Immunology in Havana.

The Cuban government has used the lure of trade to require U.S. exporters to sign letters committing themselves to lobby in favor of lifting the U.S embargo and restoring economic relations between the two countries. In a few instances, U.S. exporters refused to go along and lost the opportunity of a sale, but most of them complied with the Cuban government's request. Buying U.S. products, therefore, not only reduced Cuba's costs due to lower prices of goods and transportation, but also became a useful tactic to weaken the embargo. John Kavulich, president of the U.S.-Cuba Trade and Economic Council, established in 1994 to promote trade between the two countries and advise U.S. companies exploring business opportunities in Cuba, resigned in March 2005, blaming Cuban political tactics (surprisingly, he was repeatedly denied visas by the Cuban government instead of permits by the U.S. government); U.S. obstructions; and the unscrupulous behavior of some U.S. "two-bit hustlers" (San Martín 2005).

On February 22, 2005, the following new trade rules were enacted by the U.S Treasury Department's Office of Foreign Assets Control (OFAC), to be implemented on

March 24: (1) Cuba can no longer pay after receiving U.S. imports but must pay cash in advance before the merchandise leaves U.S. ports and (2) OFAC is empowered to shut off U.S. exports exceeding certain limits. The reaction against these measures was immediate: 38 powerful agricultural and export organizations asked President Bush not to change the status quo because their businesses would be damaged. Twenty senators from both parties in six states threatened to block any Treasury Department nominee who requires Senate confirmation, unless these new rules are suspended, and they sent a bill to overturn them. The senators also joined in an initiative to facilitate sales even more, including direct banking transactions, allowing Cuba to pay accounts directly to U.S. banks without third country intermediaries, and simpler permits for Americans to travel to Cuba for business purposes, as well as for Cuban officials to travel to the United States to inspect merchandise for buying. Cuba's trade agency (Alimport) alleges that paying cash in advance could allow U.S. courts to seize merchandise being sent to Cuba; hence, Alimport threatened to halt U.S. imports until safe conditions are restored ("Declaración..." 2005). In order to circumvent these risks, the Cuban government has been resorting to the use of credit letters from foreign banks to pay for U.S imports, but this is costly.

## **B. Conditional Normalization of Relations with the European Union**

In December 2000, Cuba was accepted by the Asian, Caribbean, and Pacific (ACP) countries of the European Union (EU) as a member, which is a requirement for Cuba to enter the Cotonou Accord and be eligible to receive aid from the \$15.5 billion development fund of the EU, established to help ACP countries. However, Cuba's entrance to the Cotonou Accord was halted in response to EU countries' support of resolutions from the UN Commission on Human Rights that censured Cuba for repressing dissidents. In December 2002, Cuba formally applied to join the Cotonou Accord. Negotiations started immediately, and the EU Commissioner for Development and Humanitarian Aid visited the island in March to advance the negotiations and open an EU diplomatic delegation office in Havana. Five days after the commissioner's departure, the Cuban government detained 75 peaceful dissidents and gave them jail sentences from 6 to 28 years. The EU demanded freedom for the prisoners; closed its office in Havana; suspended Cuba's entrance to the Cotonou Accord; imposed political sanctions on the Cuban government, including banning high ranking EU officials from visiting Cuba and participating in its cultural affairs; but invited dissidents to EU embassies on national day celebrations. In response, Castro accused the EU of being a "little band of gangsters shamefully serving the Nazi-fascist government of the United States," and the Castro brothers led demonstrations in front of the Spanish and Italian embassies in Havana and insulted the chiefs of government of both nations. On June 5, 2004, the EU unanimously approved a "Common Position," condemning the Cuban government and reiterating the demand for the release of the 75 political prisoners and an end to the repression of dissidents (Mesa-Lago and Pérez-López 2005). A resolution of the European Parliament on November 17, 2004, ratified the Common Position, called again for the release of Cuba's political prisoners, and condemned the expelling of three European parliamentarians who had landed at the Havana airport in an attempt to meet the dissidents.

In response to the EU's actions, Castro froze relations with embassies of all EU countries, banned Cuban officials from attending receptions where dissidents were invited, and virtually paralyzed EU diplomats in Cuba. With the March 2004 election of President José Luis Rodríguez Zapatero, Spain led an EU effort to change the status quo; on the other side of the ocean, the Cuban government "temporarily" paroled 14 of the 75 imprisoned dissidents for "health reasons" but warned that they could be re-incarcerated if they did not behave properly. After months of negotiations within the Committee on Latin America and among member countries, on January 31, 2005, all foreign ministers of the EU signed the Declaration of Brussels, normalizing relations with Havana, under the following terms: (1) disposition to reopen a constructive dialogue with Cuban authorities geared to obtain tangible results on political, economic, human rights and cooperation areas; (2) continuous encouragement of human rights and demanding the "urgent" and "unconditional" liberation of all dissidents; (3) although dissidents are no longer invited to national day celebrations, the EU promises to "develop more intense relations with the peaceful political opposition and with wider sectors of Cuba's civil society through a fortified dialogue"; and (4) the new policy will be revised in July 2005.

Former Czech President Vaclav Havel encouraged the EU to avoid engaging dictatorships but instead to support human rights and the dissidents; he also asked the new EU members from Eastern Europe not to forget their tragic experiences with totalitarian governments. Human Rights Watch urged the EU to avoid normalizing economic relations with Cuba until Castro liberates all dissidents and implements the needed human rights reforms (Brand 2005). It seems that the EU will withhold all economic aid to Cuba until the results of the new policy are evaluated (Calzón 2005).

In a repetition of his confrontational actions in 2003 that aborted Cuba's entry into the Cotonou Accord, one day after the EU declaration, Castro stated, "Cuba does not need Europe, has learned how to live without it." Cuban dissident Vladimiro Roca noted, in an open letter to the EU, that he had predicted Castro would ignore the EU's efforts and ridicule democratic governments (Marin 2005). The European Parliament asked Cuban Minister of Foreign Relations Felipe Pérez Roque, during his visit to Strasbourg, that Cuba make opening gestures in reaction to the EU normalization of relations. Pérez Roque refused to make such a commitment (he said: "I have not come here to pass a test"), but suggested that if the 25 members of the EU do not vote against Cuba in the UN Human Rights Commission in Geneva, the Cuban government could sign a pact with the EU on economic, social, and cultural issues, such as prisons and electoral systems (EFE 2005d; "La Habana..." 2005). If the EU complies with this demand, it would be going against the promises of the Brussels Declaration.

On the other hand, according to a the director of foreign policy for Latin America of the Spanish Chancery, the "fortified dialogue" will include the following activities: (1) every six months the EU ambassadors will meet collectively with the dissidents; (2) every month EU political and human rights advisors will meet the dissidents; (3) periodically, EU human rights advisors will meet with relatives of political prisoners; and (4) high EU officers who visit the island must raise the issue of human rights with Cuban authorities and meet with dissidents (Reyes 2005). On March 21, 2005, 12 EU

ambassadors in Havana held their first meeting with Cuban dissidents. The latter requested that the EU include the liberation of imprisoned dissidents in its negotiations with Castro, but the ambassadors did not make a commitment. Some of the dissidents attending the meeting reacted positively, while others remained skeptical (EFE 2005e).

### **C. Entry into Mercosur?**

The Southern Common Market (Mercosur) has four full members: Argentina, Brazil, Paraguay, and Uruguay; six countries are associate members: Bolivia, Chile, Colombia, Ecuador, Peru, and Venezuela. President Jorge Battle of Uruguay had vetoed Cuba's entry into Mercosur and also broke diplomatic relations with Cuba because he was upset by Castro's insults following Battle's support of the 2004 U.N. resolution criticizing Castro's violations of human rights. After the new Uruguayan President, Tabaré Vázquez, took office, he reestablished relations with Cuba, and Castro formally again requested entry into Mercosur as an associate member. An important obstacle, however, was that Mercosur's charter requires all member countries' full operation of democratic institutions, and decisions traditionally have been done by consensus. The chancellor of Uruguay thought that this requirement was only demanded from full members, but Mercosur's legal advisors informed him that it also applies to associate members. By the end of March 2005, when this paper was finished, Cuba's entry was strongly criticized by the two traditional political parties in Uruguay, now in opposition; the presidents of Paraguay, Colombia, and Peru also opposed Cuba's entry into Mercosur. Hence, the issue is virtually dead.

In contrast, Brazil, a full member of Mercosur, has helped Cuba economically on a bilateral basis. At the end of 2004, Brazil provided a credit, of an undisclosed amount, at 2.5 percent interest to Cuba for buying food (Castro 2004b). In February 2005, the two countries signed economic and trade agreements on energy, technology, education, and health. Brazil increased imports of Cuba's pharmaceutical products, the state oil corporation PETROBRAS was expected to start oil explorations in the island, and could possibly become associated with Venezuela's PDVSA to build a factory to produce lubricants in Cuba. Most surprisingly, Brazil promised to advise the Cubans on how to produce alcohol from sugar as a substitute for gasoline for vehicles, now obviously an impossible task in view of the virtual demise of Cuba's sugar industry.

## **V. ECONOMIC RECENTRALIZATION AND CUTS IN THE PRIVATE SECTOR**

Cuba's timid market-oriented economic reforms implemented from 1993 through 1996, which introduced some decentralization of decision making and a small but vibrant private sector, were virtually halted in 1996. A reversal of the reforms began in 2003 and was strengthened from 2004 to 2005, with drastic recentralization measures in economic decision making and further reduction of the small private sector. The new policies were preceded by the demotion of key architects of the reforms: Minister of Economics and Planning José Luis Rodríguez was removed from the Council of State in March 2003 and replaced by Ramiro Valdés, the hard-liner formerly in charge of internal security; Minister of Finance and Prices Manuel Millares was dismissed in June 2003; Minister of

Basic Industry Marcos Portal was fired in October 2004. The reasons for the demotions were given by José Ramón Machado Ventura (member of the political bureau of the communist party) in October 2004, when he criticized both “those who have copied capitalist methods so well that they have become capitalists themselves” and the “liberalism, lack of control and tolerance” that are affecting the entire country (cited by Frank 2004).

## **A. Recentralization Measures**

### *1. Banning of Operations in Hard Currency by State Enterprises*

This measure, enacted in July 2003, ordered all operations of state enterprises to be conducted in convertible pesos, all hard currency such enterprises had or received in the future from exports must be sold to the Central Bank of Cuba (Banco Central de Cuba—BCC), and hard currency needed for imports must be approved by the BCC. The criteria for making decisions to approve or reject individual transactions have not been released. State enterprises must pay from 1 percent to 2 percent of the value of hard currency they buy to the BCC (“Resolución 65” 2003). Controls on dollar accounts of foreigners have also been tightened and checkbooks withdrawn to force them to go to banks personally to conduct their business.

### *2. Central Control of Imports*

Cuba’s Minister of Foreign Trade Raúl de la Nuez stated in March 2004 that commerce is being recentralized from state enterprises in order to control imports. The Ministry of Foreign Trade (MINCEX) has retaken control of exports and imports that were delegated to state enterprises and is organizing committees to regulate and approve foreign trade transactions, as well as a committee to buy goods for duty free stores after branches of foreign firms performing this function were closed. In March 2004, MINCEX reduced from 43 to 10 the enterprises authorized to import videos and cancelled the permits of 61 enterprises to import computers and their components. At the end of the year, 19 enterprises and units that had been decentralized from MINCEX since 1999 were eliminated.

### *3. Prohibition of State Enterprises to Provide Hard-Currency Services*

In April 2004, the government prohibited state enterprises from conducting 87 types of services that they used to provide as side businesses to earn hard currency, in order to control those operations directly and obtain the corresponding revenue, which is needed to finance imports (“Circular 2000” 2004).

### *4. Single Hard-Currency Account at BCC*

At the end of 2004, the government ordered all hard currency income received from any source—such as payments, taxes, and contributions—by state enterprises (including the Cuban part in mixed companies and joint ventures) to be deposited in a single hard

currency account established at the BCC. The previous practice of enterprises of a state entity transferring hard currency for internal distribution has also been banned; now such funds must be deposited in the BCC's single account (discussed at the beginning of this section, V. A.1). Before any transaction, state enterprises must request permission from the BCC Committee of Hard-Currency Approval (CAD) to obtain hard currency and convertible pesos to pay for their obligations, as well as to buy equipment, raw materials, and so on. Cuban banks are prohibited from processing any transaction in hard currency or convertible pesos not previously approved by the CAD. Any lack of control or discipline will be sanctioned ("Resolución 92" 2004).

#### *5. Control of Checks in Convertible Pesos*

State enterprises are ordered to get permission from the BCC-CAD to sign checks for more than 5,000 convertible pesos. Checks on convertible pesos for payment to third parties cannot be endorsed but must be deposited in banking accounts. Companies and banks cannot accept payments or deposits unless they have been approved by the BCC. Sanctions similar to those against checks without funds will be imposed on violators ("Resolución No. 10" 2005).

#### *6. Recentralizing Tourist Enterprises and Tight Controls on Tourism Personnel*

In the fall of 2004, the government placed four decentralized state tourist companies directly under the control of the Ministry of Tourism (MINTUR). In January 2005, the following draconian regulations were enacted that applied to 100,000 tourist workers in their relations with foreigners: a ban on receiving gifts, donations, lodging, invitations to meals and parties, fellowships or trips abroad, and use of cars—without previous government permission. All gifts must be immediately reported in writing to the immediate supervisor who will decide what to do with them; electronic and video equipment will be kept by MINTUR. Tourist employees shall restrict their relations with foreigners to those strictly necessary; conversations and negotiations with foreign partners must be conducted in the presence of one witness (a euphemism for an internal security agent); employees must be discreet with information they have and not disseminate anything that could be sensitive; they must abstain from expressing ideas harmful to the government, be loyal to state politics, report in 72 hours any contact from a foreigner not related to work issues or contrary to revolutionary morale, and exert permanent vigilance on any potential action that could damage state interests. Gifts given by Cubans to foreigners in Cuba or abroad must be authorized by the MINTUR minister himself ("Resolución 10" 2005).

#### *7. Approval of State Enterprises' Weekly Budgets*

Beginning on February 21, 2005, state enterprises are prohibited from conducting foreign transactions without authorization from the BCC. All enterprises must prepare weekly budgets in advance, specifying all their planned purchases, as well as water, electricity, and other inputs; these budgets must be approved by the BCC.

### *8. System to Control Economic, Financing, and Accounting Activities*

A system of integral management that controls all economic, financing, and accounting activities (ASSETS) was applied to 401 state enterprises and agencies by March 2005. The system keeps strict control of material and financial means and automatically registers all accounting transactions in the two monetary units, hard currency and convertible pesos, exactly at the time they take place (Calzadilla 2005).

### *9. Control of Purchase and Repossession of Vehicles*

The Ministry of Finance was empowered in March 2004 to control the purchase of all automobiles in hard currency. The only acceptable applicants for purchasing vehicles are government officials, technicians, university professors, artists, and athletes, and they must prove that they have earned the hard currency from state work in the previous two years (“Resolución 54” 2004). Managers of state enterprises were simultaneously forced to turn in “luxury cars” (for example, Toyotas) to the state, and inspectors confiscated forbidden vehicles.

### *10. Further Reduction of the Small Private Sector*

The practice of self-employment by state officials, administrators, and members of the military was banned in March 2004, and, in October, permits were cancelled and new licenses halted to 40 self-employed occupations previously authorized, including clowns and magicians, activities that the government says it will aptly perform in the future (“Resolución 11” 2004). The number of self-employed workers shrank from 208,500 at the end of 1995 to 149,990 in 2003, and certainly fewer in 2004. Due to the high cost of licenses, taxes, and government harassment, most small restaurants (*paladares*) have closed, and many people who rented rooms to tourists have returned their licenses (Pérez Oliva 2005). Despite those declines, in 2005, Castro criticized the “exorbitant prices” charged by self-employed workers, owners of *paladares*, and independent taxi drivers (Castro 2005a). Furthermore, in March 2005, Castro (2005e) asserted the need for government control of products and prices in the free agricultural markets.

## **B. Causes of the Recentralization Measures**

Castro initiated the return to recentralization at the launching of “the Battle of Ideas,” a comeback to the emphasis on consciousness and voluntarism typical of previous idealistic cycles, such as the Revolutionary Offensive of the second half of the 1960s and the Rectification Process of the second half of the 1980s (see Mesa-Lago and Pérez-López 2005). The reasons given were corruption, the need for control and discipline, commitment of errors, and restoration of revolutionary morale (flaws that led to the dismissal of two cabinet ministers), as well as U.S. threats to the Cuban economy. In October 2004, Castro reported that 3,000 Cuban officials could operate using hard currency, a practice that had been eradicated. In February 2005, Castro hailed the “dishonorable expelling of the dollar” and proclaimed that Cuban sovereignty had been reinforced, as Cuban funds deposited in foreign banks cannot be seized by the U.S.

government and added: “The state is experiencing a rebirth like a Phoenix Bird, with long-wings in its flight,” state control will increase even more, leading to the solution of all problems and reduction of inequalities between those who have access to dollars and those who do not (Castro 2005a).

In his report on the state of the economy to the National Assembly at the end of 2004, Minister Rodríguez said that Castro’s principles, immersed in the Maximum Leader’s Battle of Ideas, would be applied to the economy, which sounded ominously reminiscent of Chairman Mao’s Red Book and the recanting of so-called reformist errors during the Cultural Revolution in China. In his leadership of Cuba’s recentralization reform, Castro then emphasized the need for more discipline instead of self-financing in hard-currency, in order to avoid “errors” that deplete central resources. And yet, Castro’s previous experiments in centralization, such as the 10 million ton sugar harvest in 1970 and the self-sufficiency food plan in 1986, consistently led to grave errors and economic crises. Rodríguez cited some progress in strengthening management rigor and centralizing decision making; he justified the banning of hard currency operations, stating that the decentralization of hard currency had gone further than planned and had begun to result in unnecessary expenses. “Although the economic reordering policies of 2004 raised the capacity to confront the existing difficulties, they are still insufficient and more centralization is needed” (Rodríguez 2004). Minister of Finances and Prices Georgina Barreiro (2004) informed the National Assembly that in 2005 the recentralization policies would be extended to all municipalities in the country.

Probably the most important explanation for this recent economic recentralization is the decision of an ageing and sick Fidel Castro to secure a tight transition to leadership for his brother Raúl and the Communist Party after his death. The earlier decentralization of economic decision making into the hands of thousands of managers and the tiny but dynamic private sector, which amounted to hundreds of thousands hands, involved a tremendous risk that some would resist totalitarian control.

### **C. Effects of the Recentralization Measures**

Cuba’s past history shows that in stages when economic centralization was enforced, its results were rigidity and inefficiency, with adverse effects on production and services (Mesa-Lago 2000). A Cuban economist has warned that this will occur with the recent recentralization wave (González 2003). The banning of operations in hard currency reduced the flexibility of state enterprises, caused delays in their operations, and resulted in lost opportunities; many negotiated deals were cancelled, and creditors could not collect payments. The single hard currency account at the BCC has created significant delays in buying needed imports, as well as in paying the legal 1 percent in convertible pesos to Cuban workers in the sugar, basic, and transportation industries.

Recentralization policies have also affected tourism and other activities. Hotel managers have complained that the elaboration of weekly budgets forces them to estimate how many rolls of toilet paper, light bulbs, and tomatoes will be needed during the following week, robbing them of considerable time that could be used to take care of

their guests. Tourism officials are severely disadvantaged as they try to conduct business with foreign partners, due to the absurd restrictions imposed on their relationships. The recentralization measures have contributed to the reduction in the number of active joint ventures, from 540 in 2000 to 342 in 2003, and should have an adverse effect on the flow of foreign direct investment that declined by 77 percent over the period from 2000 through 2002 (Mesa-Lago and Pérez-López 2005). In the past, restrictions or tight controls have not worked. For example, when the state parallel market was shut down in the second half of the 1980s, the black market flourished (see section VI-B-2 of this paper).

## **VI. THE DE-DOLLARIZATION PROCESS**

In November 2004, a Resolution from the BCC rejected the use of the U.S. dollar as legal tender (since its acceptance in 1993) and decreed that only convertible pesos (introduced in 1994) would be accepted by all state entities, such as hard currency shops, hotels, restaurants, bars, cafeterias, taxis, auto rentals, and so on. The Resolution decreed that state and mixed enterprises would no longer be authorized to make dollar bank deposits in cash; instead, they must use convertible pesos for business. Cuban citizens, foreign tourists, and senders of remittances who need to convert dollars to convertible pesos were to be charged a 10 percent fee (*gravamen*) at exchange houses, banks, hotels, and hard currency shops. Existing banking accounts in dollars (held by individuals, diplomats, national enterprises, and joint ventures) would be forbidden from receiving new deposits or transfers in dollars. However, newly opened accounts in dollars would be allowed, and withdrawals from such accounts would be permitted without charge, as well as the receipt of interest from CDs. Canadian dollars, Euros, British pounds, and Swiss francs would be converted without the 10 percent charge, and bank accounts in those four foreign currencies would be permitted to receive deposits and transfers in said currencies (“Resolución 80” 2004).

The BCC Resolution states that “the population can keep, without any restriction, as before, U.S. dollars . . . in any quantity” and that the measures “do not imply any type of limitation on dollar possession.” Such assurances were intended to calm the population, but it is obvious that, since November 2004, tough restrictions have been implemented on the use of the dollar, which now can only be legally used for five functions: (1) hoarding it under mattresses for potentially bad times (some experts estimate that as much as US\$500 million are now being hoarded); (2) changing it for convertible pesos, paying the 10 percent fee; (3) maintaining it in a banking account that cannot receive new deposits in dollars, and withdrawals are charged with the 10 percent fee (if a new bank account were opened before the deadline, then such account could accept dollar deposits); (4) keeping it in banking deposits and CDs in dollars that can be cashed and earn interest in dollars—between 1.5 percent and 2.75 percent—without the 10 percent fee; and (5) charging it to credit cards in dollars that are not taxable. The following section analyzes three probable causes of the restrictive dollar measures, as well as their effects on the government and the people in the short, medium, and long terms.

## **A. Causes of De-Dollarization**

### *1. The Official Explanation*

According to the Central Bank's Resolution, the cause of the measures was U.S. government pressure on foreign banks to prevent Cuba from making deposits in dollars in order to fulfill its financial obligations, as well as the U.S. State Department's creation of the "Cuban Assets Targeting Group" to stop the flow of hard currency. The background is that the Union de Banques Suisses (UBS), the biggest bank in Switzerland, accepted deposits from the Cuban government for seven consecutive years, totaling \$3.9 billion dollars, and sent false reports to the Federal Reserve Bank of New York. When the latter discovered these deposits, it imposed a fine of \$100 million on the UBS; additionally, several Federal Reserve Bank of New York employees have been fired and are under investigation. The BCC Resolution adduces that such deposits came from the government's collection of dollars from tourists and the Cuban population's purchases in TRDs. An accusation that the UBS deposits came from drug money laundering has been rejected by Cuban authorities. The official explanation does not justify the 10 percent fee, although the Resolution feebly argues that said fee is a "compensation for the costs and risks caused to the national economy by the handling of dollars" and for the tightening of the U.S. embargo.

The Cuban government will keep receiving dollars—even more than before the measures were enacted, at least in the short run—and it is not clear what it is going to do with them. The government can use dollars to buy U.S. food and agricultural products or deposit them in some foreign banks not subjected to American pressure, in order to finance dollar imports. Castro has denied that revenue from the 10 percent fee will be used for commercial transactions and has asserted that it will be used only to support the convertible peso (cited by Mayoral 2005).

### *2. A Step toward Peso Convertibility?*

Monetary duality (in pesos and dollars) has been a growing governmental concern because it impedes control of a large sector of the economy and creates "market segmentation" (rationing, free agricultural markets, TRD, and so on), as well as increasing inequality between those who receive remittances and those who do not. ECLAC (2004b) asserted that the monetary duality softened the effects of the crisis but is a "temporary solution" that has generated social inequalities, a decline in activities conducted in pesos in the domestic demand, and high costs of imports for activities in hard-currency. Hence, ECLAC recommended two goals: "eliminate monetary duality" and "reach peso convertibility" (2004b).

In November 2004, Castro stated that Cuban currency "is beginning to be accepted by international companies [and] now we have a really convertible peso whose value we will guarantee and defend" (Castro 2004a). On March 17, 2005, Castro decreased by two pesos the exchange rate of the peso for the convertible peso, a 7 percent change, but the rate works in opposite ways: the convertible peso that was exchanged for

26 pesos is now exchanged for 24 pesos, while the buying of a convertible peso decreased from 27 to 25 pesos. (That is, if you exchange 1 convertible peso, you receive 24 “regular” or “common” pesos, but if you want to buy 1 convertible peso, you pay 25 regular pesos. The 1 extra peso is commission charged by the BCC for the exchange.) Castro declared, “With this measure, we move in the strategic direction of strengthening the national currency. . . . The fate of the empire’s [U.S.] currency is to devalue; the rate of the Cuban currency . . . is to gain in value” (2005d). The BCC argued that the decrease of two pesos in the exchange is part of “a progressive, gradual and cautious reevaluation of the national currency” (“Acuerdo 13” 2005). Starting on April 9, 2005, the value of the convertible peso vis-à-vis the U.S. dollar and other hard currencies will be increased by 8 percent, leaving untouched the peso/convertible peso rate (“Acuerdo 15” 2005; Castro 2005e). The value of the dollar versus the convertible peso has actually been reduced by 17 percent when combining the new exchange rate and the 10 percent fee (\$0.83), adding new pressure for those who have dollars to exchange them for convertible pesos before the deadline.

Some Cuban economists have interpreted these measures as positive steps in reaching the convertibility of the Cuban peso (EFE 2005c).

At first glance, one could conclude that all these measures are indeed significant steps toward the convertibility of the peso, but there are seven important counterarguments:

1. What peso convertibility are Cuban authorities talking about: that of the common peso or that of the convertible peso or both?

2. The cut in the exchange rate by two pesos has had opposite effects: a minority (38 percent) of the population, those who only have pesos, are happy because they save two pesos in buying convertible pesos, but the majority (62 percent), who either have dollars or convertible pesos, are upset because they are losing two pesos when changing both currencies into common pesos and \$0.17 per dollar when changing dollars into convertible pesos (EFE 2005c).

3. The exchange measures did not meet the two ECLAC goals because they would require a complete substitution of the dollar for one single peso currency, whose value reflects supply and demand in the international market, something that would demand profound structural transformations, which are in opposition to the recentralization measures already explained.

4. The exchange rate of the “convertible” peso is set arbitrarily by the Cuban government: equal to one dollar until April 9 (actually \$1.11 with the 10 percent fee) and at \$1.08 after the appreciation (actually \$1.19 with the 10 percent fee).

5. At the new exchange rate of the convertible peso for 24 pesos, if the “convertible” peso were indeed traded in the international market, it would be exchanged for \$.04 cents instead of the officially set \$1.08.

6. Castro and the BCC have not provided any evidence that the convertible peso “is beginning to be accepted in the international market.”

7. The Euro, the Canadian peso, the British pound, and the Swiss franc continue to circulate in Cuba, and their circulation will probably increase in the future. Therefore, instead of three legal tender currencies (the dollar, the convertible peso, and the peso) there are now seven.

Because of all of the above reasons, the cut in two pesos decreed by Castro was just a symbolic, political decision geared to the outside world and a minority of Cubans who only have pesos, but it will not have any relevant economic effect, and certainly it is not a significant step toward real peso convertibility.

### *3. Underlying Causes*

The BCC Resolution’s measures can be interpreted as another step toward the recentralization process—as discussed, the closing of spaces to the private sector and the strict control of hard currency. However, the principal reason is the severe and growing scarcity of hard currency, due to the failure of Cuba’s economic policies and its huge external debt with the Club of Paris since 1986, as well as with many other countries. Cuba’s total hard currency debt was estimated at \$13.3 billion at the end of 2004, while the debt in not convertible currency (that is, the currency used by the former socialist countries) with Russia, Romania, Hungary, and Poland, excluding other Eastern European countries, was calculated at \$22.1 billion, for a total debt of \$35.4 billion, a per capita hard currency debt of \$1,776 and a total per capita debt of \$3,100 (*Cuba Facts* 2005). Because of this debt and defaults with a dozen countries, it is extremely difficult for the Cuban government to get credit and, when it does, it is short term and charged at a very high interest rate. The scarcity of hard currency has been aggravated by several problems: continuous deterioration in the terms of trade; a merchandise trade deficit of about \$3 billion from 2000 through 2004; a decline in foreign direct investment from 2001 through 2004; cash purchases of food and agricultural products from the United States that reached a cumulative total of \$1 billion at the start of 2005; extensive imports of equipment, spare parts, and goods in 2004 due to the electricity crisis and subsequent paralysis of great parts of the tourist sector; the conflict with the European Union during 2003 and 2004 that postponed Cuba’s entrance into the Cotonou Accord and reception of economic aid from EU; and the UBS scandal, which constrains Cuba’s deposits of hard currency, regardless of their sources (several of these reasons were given by ECLAC 2004c). The Cuban government has rejected the notion that the BCC Resolution’s measures were a result of hard currency scarcity, and Castro has asserted that “no revenue from Resolution 80 will be used in commercial transactions but only to guarantee the value of the convertible peso” (cited by Mayoral 2005).

## **B. Effects of De-Dollarization**

### *1. Positive Effects for the Government in the Short Run*

Despite official declarations that the new exchange measures are not intended to collect hard currency, in the short run they have generated a substantial flow of dollars through two ways: the 10 percent fee charged to convert dollars into convertible pesos and the appreciation of the convertible peso by 8 percent. The amount of remittances annually sent to Cuba range from US\$400 million to \$1 billion. If we assume that all remittances are exchanged for convertible pesos, that would generate from \$76 million to \$190 million for the government. In addition, the BCC will exert more control on dollar accounts; for instance, impeding new deposits in dollars in existing accounts, restricting withdrawals, and imposing the 10 percent fee on withdrawals from old dollar accounts and foreign representatives.

According to the president of the BCC, the number of new bank accounts opened in dollars rose ten times between October 18, 2004 (when the measures were announced on TV), and November 14, 2004, because when accounts were opened before the deadline, dollars could be withdrawn in cash or convertible pesos without paying the fee. That transaction was beneficial to those who had a modest sum in dollars that would have to be spent in the short run in the TRD in order to avoid losing 10 percent of its value. In that manner, the government captured more dollars. Additionally, the number of people changing dollars to convertible pesos in government exchange agencies (Casas de Cambio—CADECA) rose by 30 times the day after the announcement; if they had waited until the day after the deadline, they would have lost 10 percent of the dollar's value due to the exchange fee. Conversely, it is highly probable that those who had hoarded large amounts of dollars kept them under the mattress (without opening bank accounts or changing dollars in CADECA before the deadline), in order to impede the government from knowing how much they have and as a way to keep hidden dollars secure to be able to exercise more options in the future.

## *2. Negative Effects for the Government in the Middle and Long Terms*

In the medium and long terms, the BCC Resolution's measures could generate several negative effects for the government. Cubans who have plenty of dollars hoarded will try to buy items on the black market (which had been significantly reduced by the CADECA and TRD), creating more incentives for people to steal from the state in order to sell scarce goods. The black market can now sell goods at lower prices than the TRD because most supplied goods are free (they are stolen), prices in the TRD were raised by 10 percent to 30 percent in March 2004, and the Resolution further increased such prices by 10 percent due to the exchange fee. The decline in black market prices might also attract those who receive modest remittances, to save the 10 percent fee and to avoid the loss of 8 percent in dollar depreciation. In February 2005, in an article published in Cuba, I predicted a surge in the black market and that the government would launch a campaign against it and impose severe sanctions to offenders (Mesa-Lago 2005b).

On March 17, 2005, Castro stressed the need to rid the country of the black market, saying that such illegal sales compromised a system of distribution beneficial to all the people: "We must do away with the scheming. . . . We have the most just cause,

the best [political] system and we are squandering it . . . the state has to guard and educate.” He exhorted the armed forces, the Ministry of Interior, the Union of Communist Youth, and the Committees for the Defense of the Revolution to impede robberies and the channeling of goods into the black market (Castro 2005d). Castro had previously criticized the dollar sales of medicines in the streets, although those medicines are difficult to find at subsidized prices; he threatened that the government would not stay [standing immobile] with its arms crossed (Castro 2005b). But Cuban history shows that punitive measures against the black market are difficult to implement, which is the main reason why the free circulation of the dollar and the TRD were introduced.

In addition, the black market in Cuba that existed to buy and sell dollars was significantly reduced by the establishment in 1995 of CADECA. Although the BCC Resolution does not specify how dollars may be purchased, Cuban authorities have stated that the practice of buying dollars with pesos or convertible pesos continues, albeit paying the 10 percent fee for each transaction. It is probable, however, that eventually only the exchange of dollars in convertible pesos will be permitted. The Resolution’s measures will probably lead to a scarcity of dollars in the domestic market together with an increase in the demand for dollars (from those who travel abroad or give dollars to Cuban visitors to the United States to buy goods there, and so on), therefore, generating strong incentives for the reactivation of the black market in dollars. If that happens, the price of the dollar in such a market would rise. The president of the BCC has asserted that there will not be an increase in the black market because the population has “trust” in the government and its currency, and yet Castro’s statements about the black market, cited above, contradict him.

The BCC Resolution did not mention dollar remittances, but they continue to be received, at least for the time being, although the government charges the 10 percent fee when dollars are exchanged for convertible pesos. The government recommends to those who receive remittances (62 percent of the population, according to ECLAC 2004c) that they ask their relatives abroad to send remittances in any of the four authorized currencies to avoid paying the 10 percent fee for exchanging dollars. But the majority of Cuban exiles live in the United States, and it is easier for them to send dollars. Furthermore, the only agency authorized by the U.S. government to do transfers to Cuba is Western Union, which only accepts dollars. For the immense majority of Cubans abroad, therefore, the maximum amount in remittances annually allowed of \$1,200 is reduced to \$1,080 when exchanged into convertible pesos. Cubans abroad who are able to send Euros or other authorized currencies into Cuba have to pay a hefty commission for the exchange. The restrictions imposed by both the Cuban and U.S. governments may provoke a decrease in the amount of remittances.

Out of the total number of tourists who visited Cuba in 2003, 58 percent were Canadian, and the rest were mainly from the Euro or British pound zones; hence, the Resolution will not affect them. Only 4 percent of tourists who went to Cuba in 2003 traveled from the United States. The new 10 percent fee for exchanging dollars will certainly make any future vacations to the island more expensive for Americans. The restrictions imposed by the U.S. government, however, have reduced the number of

Americans traveling to Cuba by 50 to 70 percent (and reduced the number of Cuban Americans by 38 percent); hence, the effect of the Resolution would be secondary for these visitors. About 7 percent of total tourists in Cuba were Latin Americans from the dollar zone, so the Resolution might have a negative impact on them, because they are low-income tourists seeking cheap vacations.

Authorized credit cards in dollars continue to be valid and not subjected to the 10 percent fee because—according to the Resolution—they do not involve costs or risks associated with transactions in cash. But the Cubans are using an ingenious trick to circumvent the restrictions: those who have dollars and want to buy something in the TRD deliver dollars in cash to another person who has a credit card and buys the merchandise in exchange for a gift smaller than the value of the 10 percent fee. If these operations increase and become widely known, the government will try to regulate the use of credit cards or charge the 10 percent fee to them as well, with negative economic consequences for the state.

### *3. Adverse Effects on the Population and Potential Future Measures*

The Resolution's measures will further reduce the population's consumption in Cuba. Adjusted for inflation, personal consumption declined 40 percent from 1999 through 1993 and, in 2000, was still 22 percent below the 1989 level. ECLAC (2004c) acknowledges that in 2002 the pre-crisis level still had not been recovered. Before the crisis of the 1990s, the rationing quotas that covered, albeit frugally, one month of food needs, now only cover from one week to ten days, forcing people to buy the food they need through the end of the month in the free agricultural markets and the TRD. Prices in agricultural markets rose by 23 percent in 2002 and increased again in 2003 and 2004; the TRD raised their prices between 10 percent and 30 percent in March 2004. The Resolution imposed an additional de facto increment of 10 percent in TRD prices; therefore, prices jumped anywhere between 21 percent to 43 percent in 2004.

When decreeing the convertible peso's appreciation by 8 percent, the BCC said that it was "for the time being," suggesting that new appreciations will occur ("Acuerdo 15" 2005). New restrictions in the future may include compulsory exchange of all dollars into convertible pesos, elimination of bank accounts and certificates of deposit in dollars, control of credit cards in dollars or charging them with the 10 percent fee, and completely prohibiting the possession of dollars.

## **VII. CONCLUSIONS**

This paper has demonstrated that Cuban claims of an economic growth rate of 5 percent and the virtual achievement of full employment with a 1.9 percent unemployment rate, both in 2004, are statistical fabrications geared to show that Castro's reversal of the market-oriented reforms and his recentralization policies are generating strong economic positive effects. The record-breaking number of tourist arrivals and gross revenue generated from tourism in 2004 were indeed good news, but they must be tempered by the following caveats: a dramatically decreasing rate of tourist arrivals in the last five

years; a target of 2 million tourists that took six years to be accomplished and a goal of \$2.6 billion in revenue that has not yet been attained; the need to deduct high costs of inputs from tourist gross revenue; and declining occupancy rates, length of over-night stays, and average expenditures.

It is too soon to reach a solid conclusion on the real significance of the discovery of new oil deposits, but the officially estimated size of the Santa Cruz deposit is quite small and, although the crude is reported to be of better quality than that extracted from current deposits in exploitation, it still has to be mixed with crude that is lighter with less sulfur content. Furthermore, estimates of the size and quality of the crude were based on merely six days of extraction, but despite that, more than three months have elapsed since Castro announced the oil discovery (halfway through the stage of experimental production), and no additional information on size and quality of said deposit has been published.

The good domestic news reports, therefore, are bogus, exaggerated, or suspicious. Conversely, the bad news on the domestic economy is well documented and catastrophic. First, the combined loss of \$3 billion from two hurricanes and the worst drought in the last century surpassed the \$2.2 billion earned from tourism by 33 percent.

Second, a 2004–2005 sugar harvest between 1.5 and 1.7 million tons, the lowest since 1905, should result in a loss from \$100 million to \$200 million. Cuba will not be able to take advantage of higher sugar prices in the world market because most of the sugar produced for export was contracted previously at low prices; furthermore, it will be almost impossible to meet domestic needs of 700,000 tons (about half of the harvest), hence forcing continued imports of sugar at high prices.

Third, the grave electricity crisis led to losses, from the many industries that had to close and a downturn in the tourism market, estimated at \$200 million, plus the cost of additional imports that aggravated the merchandise trade deficit.

Fourth, Castro's ill-conceived economic policies have been unable to recover the GDP per capita of 1989; the output of nine key agricultural products in 2003 were from 20 percent to 73 percent below their levels of 1989, and while output of oil and nickel have surpassed earlier levels, production levels in six crucial industrial lines (cement, electricity, steel, textiles, fertilizers, and cigars) were from 65 percent to 85 percent below their pre-crisis levels or remained stagnant.

Despite such disastrous economic policies and their results, since 2003, Castro has launched a process of recentralization of decision making that reverses all the advances made by his government's market-oriented reforms undertaken from 1993 through 1996. This process of going back to a more centralized model deepened in 2004 and in the winter of 2005 and includes the following measures:

- banning state enterprises from conducting transactions and from providing 87 services in hard currency;

- requesting such enterprises to get approval from the BCC for all hard currency imports and paying a tax between 1 percent to 2 percent on the value authorized;
- disbanding decentralized enterprises that were allowed to conduct foreign trade and retaking control of other enterprises by MINCEX;
- forcing all enterprises (including the Cuban share in mixed enterprises and joint ventures) to deposit all hard currency income in a single account at the BCC and requesting its permission for all transactions involving hard currency and convertible pesos, as well as permission to sign checks for more than 5,000 convertible pesos;
- obligating state enterprises to prepare weekly budgets in advance and submit them for BCC approval; and
- taking control of previously decentralized tourist enterprises and imposing absurd controls on all tourist personnel.

In addition to the above, the small private sector has been further reduced by cancellation or suspension of permits for self-employed activities, which has led to a significant reduction in numbers of those workers. While economic decisions are increasingly concentrated in fewer hands, it is absurd that the president of the nation wastes five and one-half hours giving a speech on TV and radio explaining how to use a pressure cooker, giving recipes to housewives, and explaining how to save electricity, for example, by putting black beans in water the night before cooking them (cited by Alfonso 2005).

Castro's previous experiments with centralization and movement away from the market consistently led to dreadful economic effects, and the new measures are already creating serious problems, such as delays in receipt of needed imports, creditors who have been unable to collect payments, time taken from attending to tourists by hotel managers who must prepare detailed weekly bureaucratic budgets; a 37 percent decline in the number of active joint ventures and a 77 percent decrease in foreign direct investment.

As on previous occasions, Cuban authorities have justified recentralization measures as needed to control corruption, profligacy, and lack of discipline; confront U.S. threats to the Cuban economy; correct inequalities; and restore revolutionary morale. The real reason, however, is probably Castro's urge to secure a tight transition after his death to his brother Raúl and the Communist Party. Decentralization of economic decision making on the part of thousands of managers and those who have run the tiny but dynamic private sector, altogether including hundreds of thousands of individuals, involved a risk that these people would eventually resist the continuation of totalitarian control. Once again, the regime's stern quest for political survival has trounced economic logic and the welfare of the people.

Another important reversal of the market-oriented reforms of 1993–1996 has been the banning of the dollar as legal tender and its substitution by the convertible peso; the 10 percent exchange fee for dollars, combined with the 8 percent increase in the value of the convertible peso, results in a raise in the rate of exchange from par to \$1.19 per one

convertible peso. De-dollarization measures are officially justified by the Cuban government to counteract U.S. pressures on foreign banks to impede Cuban dollar deposits made to fulfill international financial obligations, as well as to take a significant step toward making the peso fully convertible. The first argument is true, but it results from the Cuban government's deposits of money-laundered funds that prompted the UBS scandal, while the second justification (peso convertibility) has been refuted in this paper with seven solid reasons. Actually, the principal cause of the de-dollarization is the Cuban government's severe lack of liquidity, due to its enormous foreign debt and multiple defaults, which have created an urgent need to obtain hard currency. The banning of dollar transactions is also another step in the process of economic recentralization and central control of hard currency. In the short run, the new measures have generated more dollars for the Cuban government through the 10 percent fee, the BCC's major control of dollars accounts, an increase in the number of new dollar accounts opened, and an increase in exchanges in CADECA and other authorized agencies. Nonetheless, the de-dollarization and re-centralization will not solve the grave structural problems of the Cuban economy, such as the enormous deficit in its merchandise trade balance, the scarce and costly access to foreign credit, and the chronic insufficiency of hard-currency. In the medium and long terms, the Cuban government may experience some adverse effects from its policies, such as the resurrection of the black markets in goods and dollars, a possible reduction in remittances, a decline in Latin American tourism, and increased use of credit cards to evade the dollar exchange fee. The Cuban people are the ones who have suffered and will continue to suffer from the government's policies, due to a new increase of 10 percent in the TRD prices, which further reduces personal consumption, and they face the uncertainty of new restrictions in the future, such as a total ban on the possession of dollars.

The principal external bonanza for Cuba is Venezuelan President Hugo Chávez's government's significant, increasing, and largely free buttressing of Castro and the Cuban economy, which is approximating the support given in the past by the former Soviet Union: (1) 44 percent of Cuba's oil needs are being supplied by Venezuela at half the world market price (amounting to a subsidy of \$800 million in 2005), yet the Castro government has hardly paid for any of it, incurring a \$2.5 billion cumulative debt; (2) Venezuela transfers ownership of millions of dollars' worth of oil to Cuba that is not actually delivered to the island but is sold on the world market, for which Cuba receives the income; and (3) Venezuela has made potential commitments to invest hundreds of million dollars in all kinds of production and infrastructure projects on the island, particularly in nickel and stainless steel production and oil refining. Only for political reasons (as for the Soviet Union before), Chávez is willing and so far is capable of supporting the heavy and increasing Cuban burden, based on the record high prices of oil on the world market and his control of the opposition and news media. However, if a world recession occurs or the world's petroleum supply increases significantly, the price of crude oil would decrease, thus lessening the ability of the leader of the Bolivarian Revolution to shore up his counterpart in Havana. If a recession or boom in oil supply does not occur and if Chávez stays in power and Castro's luck continues unabated, Venezuela could fully replace the defunct USSR as Cuba's economic subsidizer.

China's short-term economic aid, granted in gifts, credits, and deferral of Cuba's debt totals about \$200 million (75 percent of it to buy TV sets), a relatively small amount compared with President Hu Jintao's trade agreements and investments in other Latin American countries. The two most important deals, however, are over the long term and in the nickel industry: a \$500 million credit to resume construction of the ferronickel plant left unfinished by the USSR and some of its former East European partners and a potential \$1.3 billion investment to exploit a new nickel deposit. The two projects combined would produce 72,000 tons of nickel, doubling Cuba's current output (to this should be added a possible 16,000 tons resulting from Sherritt's planned expansion). The first project is scheduled for a 25-year period, and the second involves just the initiation of feasibility studies; furthermore, if Cuba's antiquated, energy-intensive technology of the 1940s is involved in these projects, nickel production would be very expensive and would demand substantial price subsidies from China. Even if both projects materialize and use a more advanced technology, due to their long time spans, they will not solve Cuba's urgent economic problems. Furthermore, the conflict between the successful Chinese market-socialist model and Cuba's doomed, centralized antimarket model raises doubts about how long China would be willing to invest in and subsidize the Castro regime far beyond some political gains and a supply of nickel that could be obtained more cheaply and efficiently from other producing countries.

The net balance of U.S. policy appears to be positive for Castro: the restrictive measures imposed on Cuban Americans and travel to Cuba have had a minor impact on the Cuban government (which, in turn, has used the measures as an excuse to impose tougher measures on Cubans) but have had negative effects on the people and have reversed the increasing good will between Cubans on the island and the diaspora. Conversely, the opening of trade for agricultural products and medicines has made the United States Cuba's number-one food supplier and Cuba the third largest U.S. agricultural importer in Latin America. Furthermore, the trade opening has created a split among opposing interest groups within the U.S. administration, as the Cuban government successfully forced U.S. exporters to join it in weakening the embargo.

The EU's new approach to Cuba is an oxymoron: the Brussels Declaration contains the noble principles of defense of human rights, urgent and unconditional liberation of imprisoned dissidents, and fortified dialogue with the peaceful opposition, while apparently withholding economic aid until results in Cuba are evaluated. The EU's performance-based approach is likely to collide with a stubborn, aging, unwell Castro, who has said that he does not need Europe (particularly now with Chavez's help) and has often rejected lessons on economic and democratic reforms from well-intentioned foreign leaders and nations. An important test for the EU policy has been passed, as Castro allowed dissidents to hold the Assembly to Promote Civil Society in Havana on May 20, 2005: however, he created friction by expelling from Cuba and blocking the participation of many foreign observers and individuals. A pending test is whether the government escalates attacks on the peaceful demonstration by the spouses and mothers of prisoners of conscience (Damas de Blanco) demanding their loved ones' liberation. The EU evaluation of the new policy, to be held in July 2005, will take into account the outcome of these tests.

I would like to answer this essay's initial question, whether the mix of good and bad news in 2004–2005 will save or damn Cuba's economy, by using an extended metaphor. On the domestic front, the proven, catastrophic bad news overwhelmingly overcomes the bogus, exaggerated, or suspicious good news. The antithesis of King Midas, Castro transforms everything he touches with his futile economic policies into dung. However, the Maximum Leader's amazingly good luck continues to provide him with external guardian angels (first the USSR, now Venezuela, and, to a lesser extent, China) that protect him from his disastrous mistakes at very high costs to the people. So, on the international front, the good news appears to overshadow the bad, as Cuba's weak economy is generously subsidized by Venezuela. The questions are, how long will such largesse last, and when will it reach a level that becomes unsustainable for Venezuela. Castro continues to blame the U.S. capitalist-empire devil for Cuba's economic troubles. The EU could either turn into another devil—if it holds to the defense of human rights and liberation of dissidents while withholding economic aid—or become another guardian angel—if it does not honor its principles and gives economic aid to Castro should he fail to uphold the EU's human rights provisions. Ultimately, Venezuelan aid will not save Cuba's economy from damnation—in the same manner that the Soviet Union did not—unless current policies are reversed again in the direction of the market, an unlikely prospect while Castro remains alive.

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