A Five-Year Projection for a Restructured Cuba

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This paper presents a projection for the response of the Cuban economy to a fundamental market-oriented restructuring in conjunction with a lifting of the U.S. embargo. The projection is drawn from Chapters 4 and 5 of the full study, *Cuba and the New Caribbean Economic Order* (Center for Strategic and International Studies, 1993), but this presentation is fully self-contained and has been, in a few respects, updated from the earlier publication.

I. The Political Assumption

The projection is for a five-year period, beginning at the time the embargo is lifted, and is referred to as "Cuba restructured plus five," or "CR plus five," for short. Because the economic projection needs to be based on assumptions about an accompanying political transition, however, the political transition is addressed first. There is, in fact, an interaction between the paths of political and economic change. Reasonably favorable political circumstances are prerequisite for a successful economic restructuring, while a clear prospect of economic success will tend to encourage the necessary political change. In this latter sense, the CR plus five projection will, it is hoped, convey an element of self-fulfilling prophecy.

The political assumption is for a two-stage transition to democratic government, as explained below. This assumed course is not a "most likely" prediction but, rather, a normative statement as to an optimistic yet realistic course of events. Underlying the assumption is the need for a spirit of reconciliation both within Cuba and across the Florida Straits with Cuban-American expatriates. More explicitly, the political assumption would preclude a negative course of prolonged instability and violence, perhaps even civil war, which would not only retard the economic transition but would poison political and social relationships over a much longer period, with corresponding negative impact on the investment climate and economic recovery more broadly.

The first stage of democratic transition is assumed to run for a period of up to two years and would be a rather confused and tense period of organizing the return to elected government and implementing the first steps of economic reform. Some form of interim government, broadly representative of the people and based on the need for reconciliation, would be charged with constitutional reform leading to free and open elections. An elected constituent assembly, or *constituyente*, with a mandate to draw up a new constitution, could be part of the process. Internationally observed presidential and legislative elections would follow at the end of this first stage.

The second stage, comprising years three to five of the economic projection, would proceed under the duly elected government. Again, a degree of confusion and discord can be anticipated for a new democratically elected government after more than three decades of nondemocratic rule. The assumption here is not for outstanding or even very good performance but, rather, a minimum ability to carry forward the basic restructuring of the economy, as explained in greater detail below, while maintaining domestic peace and reasonable tranquility. The newly elected government would engage with the international financial institutions for technical assistance to carry out economic reforms as well as for mobilizing official development finance and private investment. The relationship with the United States is assumed to be very positive.

Lessons Learned from Eastern Europe

Further specification is necessary about initial steps that the government can and should take for transition to a market economy, particularly during the initial two-year stage. The experience of Eastern Europe since 1989 has relevance, to varying degrees, in each of four priority areas --financial institutions, private property rights, infrastructure, and foreign debt-- that would need to be addressed.

Relations with International Financial Institutions

The earliest possible contact with the international financial institutions --the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank (IDB)-- is an important step. Technical assistance from these institutions, together with that from other governments and the private sector, will be critical for creating the institutional framework for a market economy, including financial services, investment laws and regulations, and private property rights. Also, membership in these institutions should come as early as possible, first in the IMF, as prerequisite for participation in the development banks. IMF membership will require presentation of coherent fiscal, monetary, and international financial programs, worked out in advance with Fund staff, which can, in itself, be a valuable learning process. Membership in the development banks will make Cuba eligible for substantial long-term project and other financing.

Establishment of Private Property Rights

Early establishment of private property rights is essential for transition to a market economy, and privatization in key sectors, including tourism, the service sector more broadly, construction, and small- to medium-scale agriculture, should get early attention. These are the sectors that can provide the quickest response in employment, food supplies, and foreign exchange earnings, as demonstrated, for example, in Poland. Privatization of larger state enterprises, such as those for sugar, mining, and petroleum, will be more complicated and politically sensitive and would probably be left to the second stage of constitutionally elected government.

The issue of private property rights is linked to expropriation claims by Cubans and U.S. citizens, the latter totaling about $5.5 billion. Based on the experience of Eastern Europe, a general approach of compensation rather than restitution would be more expeditious and would alleviate fears within Cuba of people being dispossessed from their homes. The approach for some industrial and agricultural enterprises, however, could be tailored so as to give special bidding status to former owners during the privatization procedure.

An early understanding on expropriation claims by U.S. citizens is important, among other things, because it is a precondition for the provision of U.S. economic assistance. Such an understanding would have to take account of agreements reached by the Castro government on expropriation claims of other third country nationals as well as any overlapping property rights from recent joint ventures with foreign firms undertaken by the Castro government.

Priorities for Infrastructure

A restructured private sector will face many needs for economic infrastructure, especially in the transportation, telecommunications, and power generation sectors. At the outset, the development banks will play a key role, together with bilateral aid donors and the private sector, in the financing of such infrastructure projects. The inevitable confusion during the initial period, and needs that will far exceed available financing, however, will make the establishment of priorities for such infrastructure project financing a critical area of decision making. The Cuban government will have a unique opportunity to begin anew in building a modern infrastructure for its economy, but it must make the right decisions with respect to first-priority needs, most appropriate technologies, and environmentally beneficial results. This is an issue that Russia and the other former Soviet republics have not yet fully addressed.

Foreign Debt

Foreign debt is a most fluid issue with respect to transition from a Communist to a democratic, market-oriented government. Poland was able to negotiate a 50 percent write-down of its official foreign debt, while Russia thus far has sought a five-year moratorium on servicing debt incurred prior to democratization. No former Communist country has yet formally stated its wish or intent to repudiate debt of the earlier Communist regime. Negotiations elsewhere in Latin America to reduce and restructure external debt, under the Brady plan, are also relevant, with Costa Rica, for example, having negotiated an effective 70 percent to 80 percent reduction in its foreign debt.

In this context, Cuba has an $8 billion debt with Western creditors, none of which is with the United States, and an estimated 15 billion to 20 billion ruble debt with the former Soviet Union. None of this foreign debt has been serviced by the Castro government in recent years. The Soviet debt is apparently denominated in rubles, which would make its market value as of mid-1993 less than $100 million.

At this stage, the best that can be said is that the Cuban economic transition team should include nimble debt negotiators who will keep abreast of precedents elsewhere in the former Communist world. A moratorium on debt servicing for at least the first two or three years of transition would be a reasonable starting point.

Invidious Comparison with the former Soviet Union

In addition to lesson-learning parallels with the East European experience, there are even more important contrasts that would face a restructured Cuba. Five such contrasts stand out, in each case to the great comparative advantage of Cuba.

The Industrial Dinosaurs

The massive and greatly overstaffed industrial and defense production complexes in the former Soviet Union, and to a lesser extent in Poland, constitute the most intractable obstacle to market-oriented reforms in those formerly Communist countries. The Russian defense complex alone employs 10 million workers and has high regional intensity. The city of Nizhny Novgorod, for example, had 450 defense plants. Attempts to convert these obsolete "dinosaur" industries to commercially competitive enterprises are largely futile. Closing them down, however, would throw millions of people out of work, which is deemed politically unacceptable, so thousands of state enterprises continue to operate with huge government subsidies, producing products that nobody wants to buy.

The situation in Cuba appears far less grave in relative terms. State heavy industry and military production play a smaller role in the economy. The main Cuban steel complex at Antillana de Acero employed only 7,000 workers before recent layoffs. Some industrial facilities, such as cement and fertilizer plants, should be convertible to profitable private production. In any event, 60 percent to 70 percent of industrial plants have reportedly been shut down, partially or fully, and the workers discharged, under the Castro zero-option autarky program. Labor reabsorption through new manufacturing and service industries should also be easier because Cuban dinosaur industries have lower regional concentration than the former Soviet Union's, while labor mobility is higher within the relatively small island.

The Unemployed Military

The more than 2 million personnel of the former Soviet armed forces present a dilemma for Russia similar to its dinosaur industries. The budget cost of maintaining such forces is crushing, while the cutbacks in personnel thus far have created enormous problems in the absence of civilian jobs and housing for those discharged. The return to Russia of several hundred thousand troops based in Eastern Europe and elsewhere poses especially acute housing problems. Loss of prestige and economic hardships for the officer corps could develop into a political threat to the fledgling democratic government in Moscow.

Cuba also has a large military establishment for a country with fewer than 11 million people: an army of 145,000, a navy of 14,000, and an air force of 22,000. The absorption of sharp cutbacks in military spending and personnel could be much easier in Cuba than in Russia, however, if managed properly. A reintegration of Cuba into the Caribbean regional economy would create very substantial civilian employment opportunities for Cuban air force and navy personnel. Civil passenger and freight air traffic, particularly to the United States, would expand rapidly, presumably including a major share for Cuban airlines. Similar growth would emerge for maritime traffic, including cruise lines, auto ferries, and all classes of cargo and fishing vessels, with corresponding needs for port facilities and ship maintenance. Trained Cuban air force and navy personnel should need little encouragement to move into these expanding job markets.

The Cuban army is much larger and would likely require more targeted assistance to facilitate transition to private-sector employment. Nevertheless, the officer corps and noncommissioned technicians are generally well trained and educated and thus potentially valuable as managers and skilled workers. U.S. foreign assistance to a restructured Cuba should place priority on the retraining of military personnel, with linkages to U.S. business schools and vocational training centers.

The Fiscal Hemorrhage

Russian inflation exceeded 1,000 percent in 1992 and could spiral even higher in 1993 unless the fiscal deficit of up to 20 percent of gross domestic product is greatly reduced. The alternative of uncontrolled inflation financed by the Central Bank printing press will inevitably lead to the collapse of the Russian reform program--sooner rather than later. The principal causes of the Russian fiscal deficit/hyperinflation dilemma, however, are the two preceding issues: the industrial dinosaurs and the unemployed army.

A noninflationary fiscal program during the initial stage of Cuban restructuring will be a central and immediate challenge for whatever government is in place. Nothing focuses the official mind more than the need to draw up financial accounts that are in reasonable balance. Financial management under the Castro government apparently has been in considerable disorder, and thus the new fiscal accounts will have to be developed largely from scratch. IMF and other foreign technical assistance will play an important role in this central task.

The fiscal challenge for a restructured Cuba in comparison with that facing Russia, however, will be much less daunting to the extent that subsidies to state enterprises and military expenditures can be rapidly reduced. As explained above, this would be far more manageable in Cuba than is currently the case in Russia.

Environmental Degradation

The former Soviet Union faces overwhelming environmental problems. In the energy sector, dangerously unsafe nuclear reactors could cost tens of billions of dollars to replace or make safer, while low-quality, coal-generated electricity pollutes the atmosphere. Lakes and rivers are highly poisoned, causing severe health risks. Large industrial complexes combine all of the above in concentrated environmental disaster areas.

Cuba also has major environmental problems. Havana's harbor is highly contaminated from industrial, maritime, and urban waste disposal. The sugar, nickel, and paper industries are polluting rivers and coastal waters. Air pollution at cement plants and other industrial sites is serious. The nuclear power plant under construction at Juragua would likely be unsafe if completed, while planned peat exploitation in swamp lands for power generation would cause wide-ranging environmental degradation.

The difference for Cuba, however, is that its environmental problems are not as extensive or far advanced as those in Russia, and they are more amenable to remedial action. New private investment together with financial resources from the multilateral development banks could be mobilized relatively quickly to stem and reverse the problems enumerated here.

Absence of an Export Strategy

Russia and the other former Soviet republics have no apparent export strategy for short- to medium-term economic recovery. Petroleum and natural gas exports accounted for two-thirds of former Soviet export revenues, and production of these products is declining, with little hope of a turnaround for at least several years. Most other former Soviet exports went to other Communist countries or were based on noneconomic barter arrangements with developing countries. Very few of these products are now commercially competitive. The former Soviet Union also does not have a natural or regional export market to develop. The European Community (EC) is a closed market for agricultural products and gives preferences to its members, which should soon include the Czech Republic, Hungary, Poland, and Slovakia but not Russia and other former Soviet republics.

Cuba, in contrast, is at the center of the Caribbean regional economy, with immediate prospects for a surge in job-creating investment and foreign exchange earnings once market forces are unleashed and the U.S. market is reopened. This is by far Cuba's greatest advantage in comparison with the former Soviet Union, although it is also the most controversial and the least clearly understood. Fidel Castro has repeatedly denied that it even exists. A Cuban export-oriented economic strategy would have a number of distinct facets that need careful examination in the context of the Caribbean regional economy of the 1990s. The conclusion drawn here, as will be seen, is decidedly optimistic for a restructured Cuba.

II. The Cuba Restructured Plus Five Projection

A five-year projection --the Cuba restructured or "CR plus five" projection-- has been made for the Cuban economy based on the foregoing political assumption. The projection is principally in terms of foreign exchange receipts, which will constitute the driving force for broader economic growth. Increased foreign exchange enables a higher level of imports, which leads, in turn, to still higher levels of investment and job creation. In this sense, it is an export-oriented strategy in keeping with the concept underlying the Caribbean Basin Initiative of the 1980s. Indeed, a restructured Cuba should become the outstanding success story for what the CBI was meant to achieve.

The initial year of the five-year period is not specified. Instead, the projection simply begins at the point when the United States lifts the embargo and grants MFN status to Cuba and Cuba begins comprehensive restructuring to a market economy. What the beginning phase of such restructuring would mean in more specific terms was explained, in part, in the preceding discussion of lessons learned from Eastern Europe and is elaborated further in the sector-by-sector discussion of the projection below. Except when otherwise specified, the projection is based on 1992 prices and levels of national income and therefore does not reflect increases in dollar values over the five-year period resulting from inflation and income-generated market growth.

The projection is an aggregate of 15 components that together come close to the total foreign exchange inflow available to the Cuban economy. The projections for some of the components (exports of sugar, nickel, and fish) are based principally on existing conditions within Cuba. Other projected components (assembly industry, remittances, economic aid, and foreign direct investment) are derived in large part from recent experience elsewhere in the Caribbean region, while still others (tourism and nontraditional agriculture) draw on both internal Cuban and regional market conditions. A few components (services other than tourism and residential construction for nonresidents) have no quantifiable comparative measure and are projected on what are believed to be reasonable yet conservative estimates.

Such five-year projections under greatly changed political as well as economic circumstances within Cuba are not meant to be precise. As described in the sector-by-sector discussion, however, the rough orders of magnitude are highly plausible, and the relative magnitudes and differing growth paths among the components over the five-year period are reasonably well established. Most important, the central conclusion of the projection is clearly substantiated, namely, that the Cuban economy can be transformed in a relatively short time into one of high economic growth and job creation, increasingly integrated with the North American/Caribbean region.

The CR plus five projection is presented in the attached Table 1. The bottom line of total foreign exchange receipts, which in Chapter 3 of the referenced CSIS study was estimated at $2.7 billion in 1992, rises sharply to $4.4 billion in the first year of restructuring and then progressively up to $9.5 billion in the fifth and final year. This represents an extraordinary three- to fourfold increase from the depressed 1992 level and contrasts sharply with a virtually flat or declining projection out to 1995 for the current Castro reform program. The approximate $9 billion to $10 billion level at the end of five years is substantially higher than the 1989 level when Soviet aid was still in full bloom.

The projection also highlights the contrasts in the relative importance of the components between the initial two-year phase and years three through five. During the first two years, tourism, remittances, and, to a lesser extent, economic aid and export credits account for almost all of the increase, more than $1.5 billion in the first year alone. Then, in years three through five, these components, except for tourism, level off or decline somewhat, while strong growth shifts to private-sector-driven components such as assembly industry, nontraditional agriculture, mining, and foreign direct investment.

The sugar component is projected to grow only moderately, and its share of total foreign exchange receipts drops from 27 percent in the first year to only 16 percent in year five. This low and declining figure compares with 67 percent as recently as 1989, based on Soviet sugar purchases above world prices, and marks the end of two centuries of Cuban history during which sugar was king.

The Components of Foreign Exchange Receipts

A more detailed understanding of the plausibility and significance of the projection requires a closer look at each component.

Exports of Goods

Sugar. Sugar exports are projected to grow moderately from $1.2 billion to $1.5 billion over the five-year period, which, at the 1992 price of 9 cents per pound, translates to an increase from 6.3 to 7.6 million tons. Some of this increase will be in sugar-derived products such as high-sucrose syrups and packaged refined sugar. The projection is based on the assumption that there will be no substantial change in U.S. sugar import policy. U.S. sugar import quotas on a global basis totaled 1.4 million tons in 1992 and are scheduled to drop to 1.2 million tons in 1993. Even if Cuba were allotted 100 or 200 thousand tons at the expense of other countries, which would involve great difficulties for U.S. trade policy, this would only amount to 2 percent to 3 percent of Cuban sugar exports. It is also assumed that privatization of sugar lands will be a lengthier and more complicated process than in some other sectors, which could delay new investment to make sugar refineries less energy intensive and thus profitable at world prices of 10 cents or less per pound. The adoption of more stringent environmental controls could also hold back growth of production. This projection might be considered a conservative estimate, and a more ambitious alternative is discussed in the concluding section of the paper on possible Cuban membership in NAFTA. Each additional million tons of sugar exports, however, would bring in less than $200 million of revenues, and thus sugar, even in the best of circumstances, will play a relatively small and declining role in Cuban export performance.

Other agriculture. The base level of $330 million of agricultural exports other than sugar is an estimate based on 1991 export levels of citrus, coffee, and tobacco of $250 million and 1989 levels (the most recent available year) for various other products. These exports are projected to grow 10 percent the first year and about 20 percent per year thereafter. Access to the U.S. market should quickly attract financing for fertilizer, new plantings, and export marketing. A trained agricultural work force and high-quality arable land are abundantly available. A quick and sharp rise in citrus export revenues, which were $120 million in 1991, can be anticipated. Current exports are of lowest-grade citrus for concentrate, a highly competitive market dominated by Brazil. With one season's application of appropriate pesticides, however, Cuban citrus can be upgraded to juice or fresh fruit quality for the U.S. market. Other likely export growth products would include mangoes, melons, pineapples, and tomatoes.

Fish. Fish exports are projected to grow from $130 million in the first year to $220 million in year five. Cuban exports were almost at the $150 million level in 1987 and 1988 but then declined to an estimated $120 million in 1992 when gasoline shortages shut down some motorized vessels. The projection here is considered reasonable if not conservative with access to the U.S. market, particularly if substantial investment in fish farming is forthcoming.

Nickel. Nickel exports are projected to rise from $300 million in year one to $500 million in year five. Based on the 1992 world price, this translates into an increase from 42,000 tons to 70,000 tons. This can be achieved by upgrades of the three existing facilities and completion of construction on the new facility at Las Camoriocas for at least partial utilization (projected full utilization is 30,000 tons). Cuba has huge reserves of nickel ore that could attract large additional foreign investments. Questions, however, about energy cost for refining the relatively low-quality Cuban ore, tightened pollution standards, and property rights for the mining sector make it unlikely that new production for export from such large new investments would come on stream during the five-year period. Foreign exchange inflow from such larger investments would fall within the foreign direct investment component, below.

Other mining. The $10 million level in year one reflects the limited exports of copper and chrome recorded in 1989. Cuba has substantial resources in these and other minerals, including manganese, laterite, and gold. Foreign mining companies are interested in developing these mineral resources but have hesitated because of the political uncertainty of mining rights obtained from the Castro government and the closed U.S. market. The projection of an increase in exports of other minerals to $150 million by year five is low compared with the longer-term potential, reflecting again the likely slower and more complicated process for establishing new mining operations.

Manufactures (mostly assembly industry). This category is projected to increase dramatically from $100 million in the first year to $900 million in year five, or by $800 million. The principal vehicle for this growth would be assembly industry within free trade zones producing textiles, footwear, electronics, sporting goods, toys, auto parts, and various other products. The projection is based on the extraordinary experience of the Caribbean regional economy during the 1980s and especially during the second half of the decade. Fore example, a representative three-country grouping of the Dominican Republic, Jamaica, and Costa Rica, with two-thirds the population of Cuba, increased its manufactured exports to OECD countries by $932 million from 1985 to 1990; Costa Rica and Jamaica, whose population together is only half that of Cuba, increased such exports by $431 million and $233 million respectively. Mexico increased manufactured exports, mostly from assembly industry, from $9 billion in 1985 to $22 billion in 1990, which indicates the full scope of the regional market. For each of these countries, 86 percent to 94 percent of the export growth went to the United States.

This rapid expansion of manufactured exports in the second half of the 1980s can be attributed to the earlier learning experience of both the private sector and government policymakers, which a Cuban government can adopt at the initial stage of restructuring. Private companies can now organize and build free trade zone facilities quickly, while at the same time recruiting assembly industry to occupy them. This means that hard currency begins flowing in from the outset of construction and the hiring of workers and that export shipments can begin within a year of ground breaking. Free trade zone enterprises can and should be financed by private investors with no foreign economic aid involved. The requisite host-government policy actions include making land available for free trade zones, placing priority on finance for telecommunications, container ports, and air freight infrastructure, and adopting supportive economic policies such as a convertible exchange rate and reasonable tax treatment.

The projected rapid growth of manufactured exports in a restructured Cuba would likewise require early government actions. The Castro government has already adopted laws to establish free trade zones and to attract assembly industry, although little will happen as long as the U.S. market remains closed. These laws would have to be broadened to permit private ownership in the construction and operation of the facilities. In addition, early agreements between the Cuban and U.S. governments on CBI eligibility for Cuba and access to the Overseas Private Investment Corporation for political risk insurance would give further stimulus to assembly industry.

Free trade zones of efficient scale require a land tract of about 1 million square feet, a local labor pool to provide 10,000 direct and another 10,000 to 20,000 indirect jobs, and a location within 15 miles of a container port and 30 miles of an international airport. There would likely be several such zones in the Havana region, drawing on the population concentration and the transportation infrastructure of the city. Others could be located on the northern coast, closest to the U.S. market, while the heavily populated Santiago region in the south would also lend itself to one or two zones. Yet another attractive location is Guantanamo Bay, close to nickel and tobacco production, which will lose its strategic justification to the United States as a military base once a friendly, democratic government is established in Havana. Location of free trade zones in agricultural areas, drawing on underutilized sugar land and workers, might attract, in addition to manufacturing industry, food processing industry for nontraditional farm crops.

An early infrastructure decision of broader potential for the Cuban economy would be the selection of one port, probably on the northern coast, not only as a shipping point for assembly industry and other Cuban exports but also as the Caribbean transshipment hub for regional container traffic, similar to facilities in Hong Kong and Singapore for the East Asian market. Cuba is favorably located for such a role, and existing transshipment facilities in the Dominican Republic, Puerto Rico, and Jamaica have significant drawbacks. A state-of-the-art modern container port in Cuba could be constructed and operated with the participation of private shipping companies and financed in large part by the World Bank.

Other exports. The "other export" category is a residual that was $90 million in 1992. It apparently includes some food products as well as mining and manufactured products not included in the earlier figures. This category is projected to grow about 10 percent to 20 percent per year to $200 million in the fifth year, which can be considered reasonable in view of the strong export performance projected elsewhere. In any event, this is a relatively small component of the overall projection.

Services

Hotel visitors. This is the highest growth component of all, rising from $350 million at the 1992 base level to $1.6 billion in year five of the projection, passing by sugar in the process to become the largest sector in terms of gross foreign exchange revenues. The projection during the initial two-year period is based principally on a sharp rise in the occupancy rates of existing "commercially competitive" hotel rooms and on higher average room rates as U.S. visitors predominate over European and other budget tour visitors. A strong surge of visiting businessmen, government officials, international civil servants, Cuban Americans, and other U.S. tourists can be expected, similar to what happened in Eastern Europe but even stronger in view of the Cuban-American dimension. An increase in average occupancy for existing hotels from 50 percent to 85 percent together with a rise in average expenditure from $500 to $700 per visitor would alone raise the $350 million base figure to over $800 million. In addition, several thousand rooms not now commercially competitive could be upgraded within several months to a year, not to mention the countless smaller hostels and bed-and-breakfast facilities that would sprout forth once dollar-wielding U.S. visitors began to arrive.

To accomplish such growth, the transitional Cuban government would have to give priority to facilitating hotel renovation and support service industries from car rental and tour bus companies to restaurants and sports facilities. Privatization of hotels could move quickly because the process of hotel management by foreign companies has already begun under the Castro government. Strong growth is projected to continue in years three to five as renovation of existing hotels and construction of new hotels gather momentum. This projection also takes account of the higher than average growth of the Caribbean tourism market, compared with national income levels, over a five-year period. The $1.6 billion level of revenues in year five, based on an average per visitor expenditure of $800 in the later years, implies approximately 2 million visitors per year, or a fourfold increase over the reported level for 1992 when the U.S. embargo was still in place. This compares with 11.5 million hotel visitors to other Caribbean island economies in 1990. The projection for Cuba may appear optimistic, but it is certainly feasible, especially if the Cuban government gives priority to supporting infrastructure for tourism, as explained below.

Cruise ships. All Caribbean cruise lines are anxiously awaiting the opening of Cuba for U.S. passengers and will make rapid adjustments in their schedules when this occurs. Many if not most cruises will include one day in Havana or Varadero Beach, which, for popular four-day three-night cruises in particular, will entail substantial rerouting away from the Bahamas and other more eastward islands. The initial constraint will be the lack of adequate docking and anchorage facilities. Cruise lines are optimistic, however, that interim accommodations will be devised pending the construction of permanent modern facilities. Some cruise ships will likely dock or anchor overnight in Cuba as a form of floating hotel. For the later years of the projection, improved facilities for cruise ships will permit further rapid growth. One study projects more than 1.5 million cruise passenger visits by year five, and the figure could be higher depending on available dock facilities. These projections also reflect five-year growth in Caribbean cruise passengers far above the growth in national income levels.

Revenues from cruise line passengers will nevertheless be relatively small. Cruise passenger spending will likely be in the order of $50 to $100 per day, with port fees and expenditures by crew members providing some additional revenue. Based on these assumptions, foreign exchange receipts from cruise ships will rise from $50 million in year one to $150 million in year five. This projection does not include, however, the most innovative concept being considered by cruise lines, namely, direct flights from New York or Chicago to Havana, with one or two nights in a Havana hotel followed by a Caribbean cruise. This would be an attractive vacation package, with considerable additional revenues accruing to Havana hotels.

The annual arrival of 1 million to 2 million hotel guests and a similar number of cruise ship visitors, not to mention anticipated daily high-speed auto ferries from Miami and perhaps the western coast of Florida, will place enormous pressures on infrastructure for the tourism sector. Airports, docking facilities for cruise ships and auto ferries, telecommunications for hotel bookings, and ground transportation all need to be part of a broad strategy. For example, the drive by automobile from Havana to Varadero Beach now takes only an hour because there are few cars and little available gasoline. This will all change when tourists start flooding in and more Cubans are able to drive their own cars. The 60-mile Mariel-Havana-Matanzas-Varadero corridor will require an integrated grid of harbors, airports, and ground transportation infrastructure, perhaps including high-speed trains or other advanced transportation technology.

Residential construction for nonresidents. Relatively few Cuban Americans plan to return to Cuba permanently and resume Cuban citizenship, but almost all talk of vacation or retirement homes there. Many non - Cuban Americans will also see a restructured, democratic Cuba as an alternative to Mexico or Costa Rica as a place to retire. In fact, Cuba should become an extension of the two-decade building boom down both coasts of Florida in condominium and warm-weather residences for vacation, retirement, or both. Anticipated direct flights to Havana from major U.S. cities and daily auto ferries will facilitate access to a Cuba uniquely offering extended beaches and the urban charms of Havana. High-rise condominiums in Havana and Varadero Beach would likely come first. Later, the techniques of Florida developers, who obtain a large tract of waterfront property and build first a golf course and marina and then a planned community of homes, could proliferate along the hundreds of miles of Cuban coastline.

A boom in residential construction for nonresidents will undoubtedly become a major source of foreign exchange inflow as foreign purchasers finance such new construction. One thousand residences at an average price of $100,000 would bring in $100 million. The projection is for a modest level of $50 million in year two followed by a sharp rise to $500 million in year five, implying 5,000 units in the latter year. This is, of course, a best guess about an entirely new phenomenon for Cuba, but a plausible one, which perhaps will prove to be conservative.

Other services. During the 1980s, global trade in services grew faster than trade in goods --7.5 percent versus 5.5 percent annually-- and developing countries have been large beneficiaries. The principal sectors for foreign exchange earnings from services for developing countries have been tourism, transportation, financial services, and wide-ranging information technology activities. There are no comprehensive statistics on trade in services by sector and country, but the Caribbean region has been a region of strong growth, integrated as it is with the highly service-oriented North American economy. A landmark "teleport" project in Kingston, Jamaica has created substantial employment of Jamaicans to supply information technology and other service-based work to the United States via satellite.

Cuba will inevitably benefit from such exports of services. With an educated labor force working for relatively low wages, Cuba could become a regional center for transportation, telecommunications, and financial services. With newly installed business infrastructure, Havana could offer clear advantages over Miami, Mexico City, and Caracas as the location for regional corporate headquarters: central location, low cost, less congestion and pollution, and a higher quality of life.

The projection for foreign exchange receipts from other services --from $50 million in year one to $250 million in year five-- is a rough estimate meant to indicate a low base level and rapid growth. It could well be a conservative estimate as the North American economy becomes increasingly service-based and Cuba becomes more deeply integrated with it.

Foreign Direct Investment

The projection of actual disbursement from new foreign direct investment, from $100 million in year one up to $800 million in year five, depends heavily on the establishment of a legal framework that encourages such investment. The laws adopted by the Castro government through 1992 move in the right direction, but more definitive and far-reaching actions would be necessary, with clearly established private property rights as the starting point. This could be undertaken during the initial two-year phase for many sectors, including hotels, small- to medium-scale service and manufacturing industry, construction, and much of agriculture. Some large-scale industry and agriculture, including sugar, mining, and petroleum, could take longer to adapt to large new private investment, as reflected in the relatively low level of investment projected during the initial two to three years.

The projected levels are based on two factors. The first is a comparison with the three-country composite noted above for assembly industry, where foreign direct investment in 1989-1990 was running at an annual level of $300 million to $400 million and where the investment climate, with some exceptions, was not particularly positive. The second factor is the well-known eagerness of Cuban-American businessmen, Cuban expatriates elsewhere, and U.S. companies in general to invest in Cuba as soon as it opens. Franchises for many U.S. brand name products and services have already been committed or are under discussion with Cuban Americans and other business interests.

Remittances

The 1.1 million Cuban Americans and a substantial number of Cuban expatriates elsewhere will account for a large initial surge of foreign exchange into a restructured Cuban economy through remittances. Much of this will come in conjunction with visits to relatives to help upgrade homes, buy appliances, and improve personal consumption generally. There will likely be some additional outflow of Cubans to the United States in the first years of an open relationship, and these recent arrivals are likely to be especially generous in sending part of their earnings back to Cuba.

The $800 million level of remittances for years one and two are based, in part, on remittances by expatriates from the three-country composite, especially Dominicans and Jamaicans. Fewer than one million of those expatriates remitted $645 million in 1989 and $522 million in 1990. The substantially larger number of Cuban Americans, with a higher average income, will initially wish to do something extra after more than three decades of Cuban isolation. The $800 million projection, tapering off to $700 million in the later years, could turn out to be conservative.

Economic Assistance

Economic aid will come from bilateral donors, principally the United States, the World Bank, the Inter-American Development Bank, and, to a much smaller extent, the UN technical agencies. It is important that the aid be used in ways that directly support the other private-sector-driven components of the projection. A recommended aid strategy elaborated in the reference of CSIS study essentially rejects balance-of-payments support or other so-called cash transfers and is directed toward technical assistance, project loans for economic infrastructure and environmental cleanup, social sector support, and financial intermediaries for the private sector.

The projected level of aid begins at a low level of $100 million in year one, reflecting the slower disbursement time frame of project assistance, and builds to $800 million in year four. A decline to $700 million in year five is an indication that once private-sector-driven growth firmly takes hold, the level of official economic assistance can begin to decline. The $800 million maximum level in year four is based largely on aid levels to the three-country composite --$868 million in 1989 and $805 million in 1990. The approximate projected breakdown of the $800 million level would be multilateral development banks $300 million, the United States $300 million, other bilateral donors $150 million, and UN agencies

$50 million.

Official Export Credits

Trade credits from official export credit agencies (the Export-Import Bank and the Commodity Credit Corporation for the United States) would be contingent on some understanding about outstanding official debt contracted by the Castro government, particularly the $8 billion of debt to non-U.S. Western creditors. Early agreement on an initial period of moratorium for prior debt would be reasonable, enabling new trade credits to the transitional government. Later negotiation of the old debt could presumably be kept separate from the servicing of export credits provided after the initial point of democratic transition and economic restructuring.

The projected $300 million level in year one, rising to $500 million annually in later years, is reasonable considering the overall anticipated foreign exchange earnings of the restructured economy, and it could reach somewhat higher levels. Most of it would come from the export credit agencies of the United States and other industrialized countries and from Cuba's Latin American trading partners. In addition, a special objective for a transitional Cuban government could be medium-term, three- to five-year credits for oil imports from Venezuela and Mexico. Such credits would be more advantageous than those of the San José Accord available to smaller Caribbean and Central American governments, which require 80 percent up-front cash payment. They could be justified for Cuba, at least during the first two years or so, as an extraordinary one-time action after three decades of grossly distorted trade with the Soviet bloc. Venezuela may be more disposed than Mexico to do this because it has surplus oil capacity and closer ties with Cuba in the petroleum sector, including potential collaboration in Cuba for oil refining and petrochemical production.

The Macroeconomic Outlook

The five-year projection is highly feasible, given the conditions of economic reform indicated and a reasonably positive political setting. Extrapolating this projected performance for foreign exchange receipts into a macroeconomic model for economic growth and employment is not possible in quantitative terms, however, because basic data on the Cuban economy are not available. It is not even possible to convert foreign exchange receipts into a firm figure for additional imports of capital equipment for investment and consumer goods because the foreign exchange receipts projection is in terms of gross receipts, while most of the projected components have an import content that will rise along with export receipts and data on this import feedback are also not available. Nevertheless, some clear lines of direction for the overall economy are evident.

With respect to the import content of exports, a restructured Cuba would have two distinct advantages compared with the circumstances currently facing the Castro government. The first advantage is that the degree of domestic value added should rise over time as the national economy becomes more market-oriented and competitive. A larger supply of hotel requirements, from food to furniture to air conditioners, will be supplied locally rather than imported. Sugar and nickel production will become more fuel efficient, and thus less dependent on imported petroleum, as refineries are upgraded with more modern equipment. Assembly industry, over time, tends to increase the share of local content as management is strengthened and capital equipment is added.

The second advantage is that the principal components for initial growth in foreign exchange have the highest net inflow content. Remittances, the largest growth component during the first two years, is 100 percent dollar inflow with no offsetting import content. Economic assistance likewise has a very high net inflow of hard currency because it takes the form of grants or concessionary loans with grace periods and long-term repayment schedules. Official export credits will also have a relatively high net inflow, at least during the initial years of restructuring, because there would be no offsetting repayments on earlier credits. In sum, the net inflow of foreign exchange compared with the existing situation is favorable to a restructured Cuba and should improve over time. Put another way, the projected doubling of foreign exchange receipts during the first two years should far more than double the foreign exchange available for new investment projects and consumer goods.

In any event, the export-oriented growth model presented in the CR plus five projection would generate high gains in employment. Almost all of the key sectors projected for strong growth--tourism, other services, assembly industry, nontraditional agriculture, residential construction for nonresidents--are labor intensive and include a relatively high share of professional and high- or semiskilled jobs. These lead sectors, moreover, will stimulate high employment growth elsewhere in the economy. A construction boom will likely sweep the country for commercial as well as residential building, involving both new construction and restoration of existing structures. Each assembly industry job creates one to two support services jobs in retail trade, commuter transportation, and residential construction. Well-paying jobs in the export-oriented sectors will, in general, stimulate all manner of consumer goods production in the national economy.

Translation of this export-led, high employment generating model into a growth rate for gross domestic product (GDP) is even more elusive, but again the rate of growth should be relatively high, probably reaching at least 5 percent annually and possibly higher by the end of the five-year period if the policy program for private-sector restructuring is forcefully implemented. Even more important than the specific rate of growth is that high growth should be sustainable over time. The five-year projection only brings the restructuring process to the point where the private-sector-driven sectors are becoming dominant, and they are the ones that can provide a self-sustaining rate of economic growth over the longer term.

Finally, there are the related issues of exchange rate for the peso, inflation, and wage levels. No projected exchange rate is attempted here, but one critical contingency will almost certainly not occur with regard to the peso, namely, uncontrolled depreciation as happened to the Russian ruble. In this most important further invidious comparison with the former Soviet Union, the key difference is the absence of an export strategy on the part of the former Soviet republics, which has led to the free fall of the ruble far below a reasonable equilibrium rate, with hugely distorting consequences for their national economies. Cuba, in contrast, will benefit from a large initial surge in foreign exchange inflow, doubling in the first two years, and this should provide confidence in the foreign exchange availability to maintain the peso in a relatively stable range of equilibrium.

Controlling the accelerating inflation currently under way in Cuba will be a matter of fiscal management. Eliminating subsidies to state enterprises and reducing the exorbitant military budget will constitute the central challenges, but the prospect of high employment growth in the export sector, as explained above, should make this a less difficult process than in Europe's formerly Communist states. The cusset Castro austerity program is already undertaking a part of the adjustment by shutting down nonviable state industrial enterprises.

Wage rates in Cuba should not plunge along with the exchange rate, as is happening in Russia, but they will nevertheless remain relatively low compared with those of other countries in the Caribbean region. Although Cuban export-oriented sectors will become highly productive, wage rates tend to reflect average productivity in the national economy, and in this respect Cuba will lag badly. Overstaffing of state enterprises, a huge government bureaucracy, a military of inordinate size, and the recent shift to more primitive, labor-intensive agriculture all drag down average productivity, and at the outset of restructuring this is where the large majority of the Cuban labor force will be located.

Thus wage rates during the initial years of a restructured Cuba will tend to be toward the low end of levels within the Caribbean region, probably less than half or only a quarter of those in Mexico and Venezuela and significantly below those in other Caribbean economies. Over time, however, if restructuring brings the positive results indicated, real wages will rise steadily. In the interim, relatively low wage rates in Cuba will be a mixed blessing, with the low labor and other costs making the country one of the most attractive locations in the region for new investment and job creation.

The NAFTA Option

The CR plus five projection is based on Cuba receiving MFN treatment in the U.S. market, which would include related preferential market access as a developing country. This preferential access would involve the benefits of the generalized system of tariff preferences (GSP) at the outset and negotiated qualification as a participant in the Caribbean Basin Initiative by year one or two of the transition. A more far-reaching step would be Cuban accession to the North American Free Trade Agreement. Such a step would depend on the political orientation of a democratically elected Cuban government. NAFTA membership could be resisted on the grounds that it would entail even higher dependency on the U.S. economy. On the other hand, there would be fewer deep-seated protectionist interests opposed to free trade in Cuba compared with other countries in the region because a restructured Cuba would be starting the private sector anew. In any event, if a newly democratic Cuba were to request accession to NAFTA, there would likely be a prompt and positive response by the United States, Mexico, and Canada. This could all come about by year three or four of the five-year projection, and it is therefore appropriate to address the likely consequences here.

NAFTA is a comprehensive agreement, going far beyond the elimination of border restrictions on trade in goods. It includes open markets for trade in most services, including financial services, telecommunications, and transportation, protection of intellectual property rights, national treatment and other provisions for foreign investment, and dispute settlement mechanisms to curb unilateral restrictions, particularly by the United States. The benefits of such an agreement for the Cuban economy would fall into two distinct categories: improved access to the U.S. market and a more positive investment climate in Cuba.

Improved Cuban access to the U.S. market would be significant in a number of sectors. The textile sector could offer the greatest enhanced export prospects because U.S. tariffs as well as quotas would be eliminated under NAFTA, some immediately and others over a maximum of 10 years. It is noteworthy that U.S. tariffs on textiles and footwear are not included within the GSP and CBI preferential duty-free treatment. Cuban exports of fruits and vegetables should also benefit because most trade restrictions will be eliminated within NAFTA, although certain exceptions on sensitive trade would likely be an issue for negotiation. Exports of automotive parts from Cuba might also be stimulated significantly because NAFTA includes a provision whereby automobiles require a 62.5 percent "North American content" in order to qualify for free trade. Automotive parts sourced in Cuba would qualify as North American content, and with wage rates in Cuba far below those in Mexico, automobile companies, Japanese as well as U.S., would find it attractive to establish production in Cuba. An additional benefit for such companies would be the resulting positive corporate image in a Cuban market for motor vehicle sales growing rapidly after more than 30 years of embargo and very low imports.

Access to the U.S. market for Cuban sugar would be a major issue of negotiation for Cuban access to NAFTA, but the outcome is unpredictable and likely to provide only limited benefits to Cuba. NAFTA provides gradual liberalization of bilateral Mexico-U.S. trade in sugar, the application of tariff quotas on third-country imports after 6 years, and total elimination of restrictions on bilateral trade after 15 years. Cuban accession would nevertheless certainly entail special provisions for the very large Cuban sugar production. A modest, gradually increasing quota over a lengthy 10- to 15-year period, with a scheduled review of the situation at the end of the period, would be one possible outcome. The bold option would be a 15-year transition to free trade in sugar between the United States and Cuba, but this would mean a fundamental change in U.S. sugar policy from the current highly protected domestic price, which is more than double the world market price. Such a restructuring, with corresponding adjustment assistance for domestic sugar producers, is feasible in a U.S. political climate stressing the need to strengthen international competitiveness and could be helped by support from influential Cuban-American sugar producers in the United States if they chose to sacrifice protection in the U.S. market for new opportunities in Cuba. At this point, however, the likelihood of such an outcome appears to be very low.

The improved investment climate in Cuba from NAFTA membership could be even more beneficial to Cuban economic recovery and growth. NAFTA membership would constitute the most credible assurance that a market-oriented restructuring within Cuba would not be reversed. Provisions in the areas of trade in services, investment, and intellectual property rights would be decisive factors for many potential investors, while duty-free entry into Cuba would reduce costs for many industries and restrain inflation. All of these arguments were used by President Carlos Salinas de Gortari of Mexico and his government in making the case for Mexican membership in NAFTA, and they could apply even more forcefully for the smaller Cuban economy, which would be under a cloud of political uncertainty after so many years of Communist rule and isolation.

The aggregate economic benefits to Cuba from NAFTA membership cannot be quantified, but they would certainly raise substantially the $9.5 billion projection for foreign exchange receipts in year five as well as the economic growth path beyond. More fundamentally, Cuban entry into NAFTA would extend the integrated North American/Caribbean market a critical step forward by incorporating the centrally located and largest island in the Caribbean. This would have, in addition to the direct effects on the Cuban economy, substantial impact on others in the region, particularly the other island republics.

III. Conclusion

A restructured Cuban economy, reintegrated with the Caribbean regional economy, has potential for a strong, export-oriented recovery. During the first two to three years, moreover, the anticipated surge in foreign exchange availability, a more than doubling in the projection here, comes from sources not dependent on fundamental legal and political reforms that will take considerable time to implement. The legal framework for private foreign control of hotels and assembly industry is already on the books under the Castro government. Remittances from expatriate Cubans, economic aid, and trade credits can likewise flow into Cuba almost immediately after political transition has begun. Even over the longer, three-to-five year term, the bulk of job-creating private investment will likely be in small-to-medium-size businesses in the service sector and non-traditional agriculture, again a politically less contentious prospect based on recent experience in Eastern Europe.

Indeed, the most important conclusion of the analysis here is that a radical market-oriented restructuring of the Cuban economy need not cause the kind of economic collapse and chaos as is happening in parts of the former Soviet Union. A restructured Cuba will have some parallels with the experience of the former Soviet Union, and some lessons to be learned from it, but the circumstances currently facing Cuba differ greatly from those of the former Soviet Union in key aspects, almost all to Cuba's great comparative advantage. The most important difference is that Cuba is situated at the center of the Caribbean regional economy. Contrary to dire predictions from the Castro government, an early and highly positive response from transition to a market economy is eminently feasible for Cuba.

**** See Table 1. Below Table 1**

The CR Plus Five Projection

(In Millions of U.S. dollars)

Source of Foreign Exchange Receipts	Cuba Restructured Plan Plus Five (Years) 1992	1	2	3	4	5
Exports of Goods	2,150.0	2,200.0	2,490.0	2,910.0	3,350.0	4,270.0
Sugar	1,250.0	1,200.0	1,250.0	1,300.0	1,400.0	1,500.0
Other agriculture	330.0	360.0	450.0	550.0	650.0	800.0
Fish	120.0	130.0	150.0	170.0	190.0	220.0
Nickel	250.0	300.0	350.0	400.0	450.0	500.0
Other mining	10.0	10.0	20.0	50.0	100.0	150.0
Manufactures (mostly assembly industry)	100.0	100.0	150.0	300.0	600.0	900.0
Other	90.0	100.0	120.0	140.0	160.0	200.0
Services	350.0	900.0	1,225.0	1,600.0	2,025.0	2,500.0
Hotel visitors	350.0	800.0	1,000.0	1,200.0	1,400.0	1,600.0
Cruise ships	0.0	50.0	75.0	100.0	125.0	150.0
Residential construction for nonresidents	0.0	0.0	50.0	150.0	300.0	500.0
Other service	0.0	50.0	100.0	150.0	200.0	250.0
Foreign direct investments	50.0	100.0	200.0	400.0	600.0	800.0
Remittances	100.0	800.0	800.0	700.0	700.0	700.0
Economic assistance	30.0	100.0	30.0	600.0	800.0	700.0
Official export credits	0.0	300.0	500.0	500.0	500.0	500.0

Total All Categories 2,680.0 4,400.0 5,515.0 6,710.0 8,175.0 9,470.0

Source: Ernest H. Preeg and Jonathan D. Levine, Cuba and the New Caribbean Economic Order,

The Center for Strategic and International Studies, Washington, DC. 1993.