Redefining Cuban Foreign Policy: The Impact of the “Special Period”

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Table of Contents

Introduction

H. Michael Erisman (Indiana State University)
“Between A Rock and A Hard Place: Survival Strategy in Cubás New Foreign Policy” (34 pages)

Background

Antoni Kapcia, University of Nottingham, U.K.
“Political Change in Cuba: The Domestic Context for Foreign Policy” (37 pages)

Carlos Alzugaray, Instituto Superior de Relaciones Internacionales, Havana
“Cuban Foreign Policy during the Special Period: Interests, Decision-Making, Aims, Outcomes” (35 pages)

Jorge Mario Sánchez-Egozcue, Centro de Estudios sobre los Estados Unidos, Havana
“Redefining Cubás International Economic Interests” (38 pages)

Multilateral Relations

Joaquín Roy, University of Miami
“Cuba and the European Union: Chronicle of a Dead Agreement Foretold” (35 pages)

John Walton Cotman, Howard University
“Caribbean Convergence: Contemporary Cuba-CARICOM Relations” (45 pages)

Hal Klepak, Royal Military College of Canada
“An Asset Not Fully Exploited, or Not Fully Exploitable? Reflections on Cubás Relations with Latin America and Its Institutions” (31 pages)
Carlos Oliva and Gary Prevost, St. John’s University
“Cubás Challenges and Opportunities Outside of the Free Trade Area of the Americas”
(37 pages)

**Bilateral Relations**

John M. Kirk (Dalhousie University) and Peter McKenna (University of Prince Edward Island)
“Cuba, Canada and Constructive Engagement: A Decade of Bilateral Relations”
(30 pages)

Mervyn J. Bain, University of Aberdeen, Scotland
“Gorbachev and Cuba: His Legacy for Russian-Cuba Relations in the 1990s”
(31 pages)

Christopher Paetzold, Universidad Complutense de Madrid
“Spanish-Cuban Relations, 1990-2003"
(37 pages)

Georgina Sánchez, Asesores Internacionales en Prospectiva, Mexico City
“Mexico-Cuba Relations: Between Interests and Principles”
(28 pages)

**Cuba-U.S. Relations**

Philip Brenner, American University
“Overcoming Assymetry: Is A Normal U.S.-Cuban Relationship Possible?”
(39 pages)

Soraya M. Castro Mariño, Centro de Estudios sobre los Estados Unidos, Havana
(44 pages)

**Bibliography**

501 pages doubled-spaced

Average chapter length of 35.8 pages double-spaced
Chapter 4

"Redefining Cuba's International Economic Interests."

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**Introduction**

With the implosion of the socialist bloc at the beginning of 1990s, Cuba was forced to introduce a complex and still inconclusive program of economic reforms. After surviving the most critical period from 1991-1993, which included an aggressive contraction of trade and economic activity, as well as high rates of inflation and unemployment, changes to guarantee macroeconomic stability and political control were gradually introduced and cautiously administrated. This new direction was preceded by popular consultations that served to build a basic consensus to tackle the adjustments and reaffirm the preservation of the socio-economic model.

The economic revival has been supported by a profound restructuring of international trade relations, institutional mechanisms, macroeconomic policymaking, administrative management, industrial operations, the banking and commercial sector, and, to a lesser degree, private owners. The adjustment process has been sustained for ten years now; and the economy has been reanimated and totally reorganized under completely different foundation from the structure that was in place in the preceding 30 years. Given the level of fundamental imbalances that still exist, the recovery has not yet demonstrated total sustainability, but it is evident that the situation has changed
qualitatively compared to the initial moments. Despite the lack of structural equilibrium that persists, reforms have paved the way toward moderate but steady continuity of economic activity and growth, facilitating conditions to move forward consolidating and expanding indispensable changes.

In the Cuban case (a relatively small island economy that is absolutely dependant on trade and suffers from a chronic insufficiency of domestic resources), the economic international insertion is the central piece for any strategy of development. Moreover, in order to consider more wisely the potential and challenges in present times, we must re-examine the lessons learned from the past, as well as analyzing present strengths and weaknesses. Current and future developments, whatever the scenarios, are conditioned by three key factors--the structural heritage from the socialist relations, the outcomes for the process of reforms now in place, and the resolution of the conflict with the United States.

The aim of this chapter is to reflect on the evolution of Cuba’s international insertion and its prospects in light of the renovated process of integration in the Americas along with a dual component involving reinforcement of south-south, as well as bilateral free trade agreements and preparations for the American initiative of the Free Trade Agreement of the Americas (FTAA).

The scope of the evaluation is assumed to be for the short and medium terms; that is, intermediate targets from two up to four years ahead, with particular attention to the potential for instability in current arrangements that support flows of trade and investment from each major area of relevance--Europe, North America, Latin America and the Caribbean. The key components of this analysis consist of: a description of
the basic components of the transformations in the 1990s and their structural limitations; the identification of the main characteristics of the current model of international insertion, and an assessment of the extent to which this model converges with or differs from tendencies in its natural geographical area; and finally, an evaluation of future challenges and choices for the Cuban strategic economic interests with regard to its international insertion given the intensification of regional process toward free trade.

The content is divided in three main sections. The first section describes briefly the configuration of trade and financial integration with the socialist bloc and the reform package that followed its collapse. The systemic nature of the inherent lack of equilibrium resulting from the exigencies that forced Cuba to reconfigure its international economic relations as well as its domestic economic structure, is reviewed in the second section in order to identify strategic constraints on the way to a more dynamic international insertion. Finally, the third section discusses the current pattern and viability of strategic alternatives for each of the areas of exchange, with the intention of identifying sources of challenges and opportunities needed to promote a successful international insertion in accordance with the country’s areas of potential.

**Brief Historical Overview: The 1990s, Crisis and Recovery**

In February 1960 Cuba signed the trade and economic agreement with the Soviet Union under which a barter exchange mechanism began. The Soviets provided trade credits and crude oil, petroleum products, machinery, wheat, chemicals and fertilizers in exchange for Cuban sugar. The formal entrance in the block of socialist
economies took place in 1972 when Cuba joined the Council for Mutual Economic Assistance--also known as CMEA. An important characteristic of CMEA was the policy of setting prices for intra-block trade that were based on agreements to use the average of the previous five years of world market prices. This system worked in practice as an implicit subsidy for Cuba, allowing the country to receive substantial resources simultaneously with transfers in the form of economic assistance or development credits, estimated at SUS6.6 billions (from 1960-1990, at the 1:1 official exchange rate) (Rodríguez, José L.1992: 57).

For over 30 years the Cuban revolution enjoyed a substantial advantage compared to its geographical neighbors. None of the Caribbean or Central American countries received the amount of resources that for so many years benefited the economy of the island, allowing Havana to carry out a massive process of industrialization in agricultural production (sugar, citrus) and some manufactures (textiles, cement, steel), to make long-term investments in infrastructure (ports, airports, railways, communication and power networks), to build up cargo and air fleets, to reach high standards of education, and to develop an impressive structure of national defense. None of this could have been achieved without the special relationship resulting from the international context of Cold War and the bilateral conflict with the United States.

There is a shocking paradox when one has to evaluate the net assets of these years of profound changes and tensions. On one hand, there were substantial changes in the economic structure and social standards with an enduring impact. Compared to regional results, the rank on Human Develop Index from UN put the country well ahead of other Third World nations with similar resources. But on the other hand, if
success is not only about social indicators but also concerns the capacity inherited to survive and adapt to new circumstances, then all these achievements were based upon an extremely shaky foundation, that suddenly found itself on the edge of collapse when these special relations disappeared. Indeed years later, after a considerable cost has been paid, the country is still fighting to find the way to recover growth on a truly sustainable basis.

Not everything, of course, has external causes. There were also “endemic disorders,” particularly with regard to economic efficiency at both the domestic and the international levels. In the case of foreign trade, commercial dependence has been an historically chronic component of Cuba’s economic history. By the end of the 1950s, for example, the United States supplied 60-70 percent of Cub’s imports. After the revolutionary victory in 1959, bilateral trade dropped to barely 4 percent in 1961 (Losman, 1979: 21), while the Soviet Union, China and the socialist countries gained in importance, representing nearly 85% of Cuba’s total trade by the late 1980s (with the Soviet Union accounting for roughly 90% of the island's trade with the socialist countries).

The Implosion of the Socialist Bloc: From Survival to a New Pattern of Economic Growth and International Insertion.

Some analysts define 1990 as the turning point in Cuban foreign economic relations after the collapse of the Soviet Union and the CMEA. There is no doubt that since then things has never been the same, but a closer examination reveals that the crisis has two previous symptoms, the so-called “process of rectification of errors” in the mid-1980s (a policy shift to reverse distortions and tensions that resulted from
monetary incentives and over-employment generated by measures introduced to experiment with some decentralization and market mechanisms), and the visit to the country in 1989 of Mikhail Gorbachev. Two significant outcomes resulted from these events: 1) the end of military “protection” from the Soviets; and 2) the beginning of a new era in economic relations due to the introduction of reforms in the USSR (perestroika), the objective of which was to improve efficiency by reducing state control over the economy. As a result of these changes, the economic transactions among socialist countries now took place in world prices and using hard currency, a policy which had an immediate negative impact for Cuba. All economic transactions were soon forced to adjust to the progressive removal of economic assistance and subsidies in the form of special prices, soft credits, and guarantees of financial resources and market access.¹

For Cuba, the adjustments were severe but there was a certain confidence rooted in the basic continuity of links created over more than two decades involving similarities in markets, technologies, the culture of business practices, and perhaps the perception that difficulties inherent in a massive transfer of socialist trade relations toward international markets would require time. The best way to confirm the Cuban attitude of “wait and see” was the absence of alternative or concrete emergency plans for unexpected deeper complications. The sudden collapse of the whole bloc of socialist countries was the final catalyst for a process already under way in Cuba. Confronted with the abrupt disappearance of credits, traders and governments,² there was no choice for Havana but to apply draconian reductions and pursue the path of reforms at an ever-increasing pace. The emergency plans became known as “option zero,” that is, survival for the island with almost zero trade, (oil imports, credits,
revenue from exports, technical assistance, etc). This initiated the first reforms as the shock upon foreign trade turned into a major structural transformation.

**Short and medium term adjustments**

The package of measures approved by the Cuban government has a dual component. On one the hand there was the problem of short-term accommodation to the contraction of economic activity, growing unemployment, rising inflation and trade relocation while searching for ways to distribute the social impact and preserve the structure of social services. The other involved the inevitable task of reconstructing the basis of the country’s economic structure according to new circumstances, that is, “institutions, policymaking and priorities on macroeconomic relations” (Rodríguez, José L., 1998).

The most relevant measures taken were: the decentralization of foreign trade by eliminating the state monopoly (1992-93); the legalization of the use of US$ dollars (August 1993); the legalization of self-employment and the conversion of state farms to agricultural cooperatives called Basic Units of Cooperative Production, or UBPC (September 1993); the restructuring and downsizing the state bureaucracy (April 1994); and the opening to Foreign Direct Investment through Law No.77 (dealing specifically with FDI, in September 1995) in conjunction with a new law for environmental protection. Law 77 allows for the first time the possibility of foreign investment with 100% foreign ownership and investment in all sectors except public health, education and the armed forces. It also permits direct export-import operations for joint ventures and foreign-owned enterprises. The primary aims of this law were to
promote insertion into new markets, to facilitate the acquisition of modern technology, to attract capital, to bring new management practices to Cuba, and to encourage the promotion of exports. Other measures were introduced in the following two years such as the creation of a new banking structure (including an opening foreign banks), a new tax system with parallel increases in prices for subsidized goods and services, and the approval of new markets (agricultural, artisans and industrial goods).

The stabilization and partial liberalization program achieved its main goals of avoiding economic collapse, helping to recover economic growth, and rebuilding the structure of domestic and foreign economic relations on a very different basis, emphasizing the need for efficiency while maintaining the need to meet social objectives. In general, the measures taken were successful: inflationary pressures were stopped; the GDP deflator was reduced more than 12% with stability (on the informal market, the exchange rate also recovered from 150 pesos per $US to 22 pesos, plus/minus 2 points); the aggregate demand reacted positively--as did productivity; state subsidies were drastically reduced, helping to reduce the fiscal deficit from 30% in 1993 to around 2% in three years; national savings rose strongly (mainly supported by remittances from Cubans living abroad); unemployment was reduced to affordable numbers (between 4 and 6%); and in recent years there has been a modest but constant surge in social spending as conditions allow some redistribution of transfers from profitable sectors. Foreign direct investors have been cautious, but have had an impressive impact in some sectors (mainly in tourism, mining, oil, energy production, telecommunications, airports). In sum, there has been a steady renewal of economic activity with a surge in efficiency, but there is still a long way to go to recover to levels of activity similar to those of the late 1980s.
New actors such as foreign banks and enterprises and new institutional structures such as the segmentation of markets, dollarization, family remittances from abroad, and modest private economic activity emerged from these reforms. The geographic distribution of trade also changed notably. In the 1980s, international economic relations were subordinated to the ideological conflict and the exigencies of the Cold War, leaving Latin America and the Caribbean at a second-priority level. When the framework changed, the necessity of diversification naturally brought about a revaluation of south–south relations and the reinforcement of links with industrialized countries from the north (such as Canada and the European Union) as a significant counterbalance to the US policy of isolation. The former CMEA bloc accounted now for a modest 15% of trade, with a clear transfer in favor of countries from the European Union, Canada, Latin America, and Asia. Cuban trade relations are for the first time in a century distributed between all geographic regions without absolute dependence from a single country or block. However, the pattern of geographic location of trade--or market orientation--shows major differences from that of the Cuba’s Caribbean neighbors.

**New markets, old problems**

Globalization is basically a process of the internationalization of economic relations at a supranational level. The organization of production takes place in integrated networks of finances, trade and “dislocated” productive relations. Access to those networks is an imperative for countries which wish to escape the pattern of specialization in primary commodities. Consequently, access to international markets requires countries to adapt national policies to prevailing conditions (ECLAC,
The commercial strategy is just one of several components in a group of transformations that differs from one country to other. The Cuban transformation on trade relations was associated with the whole process of structural reforms in the 1990s that was, and still is, inconclusive.

For Latin America, trade policy liberalization in the 1990s was part of a larger outward-oriented development strategy. Agreements were negotiated in the spirit of open regionalism and designed to be complementary with the current framework on trade obligations found in the multilateral regulations of the WTO. The policy decisions about import liberalization and export promotion have become the core of regional integration agreements. There is no opportunity to boost economic growth and welfare without more trade, but on the other hand, the uncontrolled liberalization of imports in a world of transnationals and sophisticated forms of protectionism in developed countries could end in the destruction of domestic industries, particularly for small and medium enterprises (De la Reza, 2003:767).

Pressures for short-term liberalization came in two ways: one as a component of bilateral free trade agreements and custom unions reached as part of strategies to protect (e.g. South America) or prepare (e.g. Caribbean and Central America) for the FTAA, with the inclusion of some mechanisms of adaptation and compensatory measures; and the second is the FTAA, which seems unlikely to be fully applied by 2005, as was originally expected. There are two basic scenarios: one involves some kind of coexistence between existing bilateral agreements and the FTAA, with a country-by-country scheme of integration with FTAA; and the second entails a progressive dissolution of current agreements, blending into the FTAA, with the first of these two scenarios as the more likely for the near future.
The Cuban approach has a different setting. As a founding member of GATT/WTO, tariff levels were reduced from an average of 52% to 16% in three revisions (1990, 1992 and 1996) and the level applied to countries with most favored nation--MFN--status is between 17.7% to 10.7%. The average tariff level today is around 10-12%, consistent with the regional parameters. In Cuba tariffs do not act as the main factor to administer foreign exchange. But central planning over imports, restricted by the availability of cash, is the main challenge now resulting from distorted incentives to increase excessively imports due to the combination of an overvalued exchange rate and the low level of tariff for imports.

The composition of Cuban exports is completely dominated by primary products (90%). Manufactured products that intensively use local natural resources have a low level of participation (5%), as is also the case with technology (2%) and human capital (2%) inputs. The most contradictory finding here is the low content exports associated with the human capital factor, which paradoxically is one of the most important reserves generated in decades with substantial investments. The recent dynamic evolution is heavily concentrated on exports of goods based on natural resources (increases of 26%), as reflected in the boost on mining (nickel) and some increases in sugar, fruits and juices. The evolution of exports with technology content has contracted (-26%) while there has been a modest expansion in those related to human capital (5%) and labor force increases (4%).

Greater activism in exports of natural resources means continuity with the historical pattern of specialization in trade: primary commodities (now switching toward services--most noticeably, tourism--as a leading component on the commercial
balance) while in comparison the most dynamic areas of world and regional trade are
those related to information technology, manufacturing and human capital. These are
clearly the sectors with both the most rapid growth and returns, and the Central
American countries are moving increasingly in that direction. Caribbean nations, on
the other hand, are concentrating on the service sectors (tourism and financial),
mining, agricultural products and light manufactures.

The main sources of Cuba’s income in 2001 were: tourism (41%), nickel
(14%), sugar (10%), and to a lesser degree, transportation services (6%) and the
fishery (2%). The first three first account for 64% of total income (Pérez Villanueva,
2003:25). With little variation since the mid-1990s, the structure of dollar-earning
activities remains the same with tourism, sugar, remittances and nickel as the most
prominent areas. In the next few years, it is hard to believe that there could be
significant changes in this structure if conditions remain relatively unchanged with
regard to access to both markets and finances. The structural shift from sugar toward
tourism also brings new challenges to the current development strategy. The growing
over-dependence on tourism as the engine of growth could in fact increase structural
weaknesses by reducing support for development in other areas with potential such as
manufacturing, electronics, software, medical equipment and medicines. On the
import side, food, oil and medical supplies account for more than 60% of the total, and
more significant, they absorb proximately 80% of the country’s foreign income (Pérez

One of the greatest problems facing the Cuban economy is the issue of the
nation’s balance of payments. The size of the current-account deficit is constrained by
the availability of external finance. During the 1990s a merchandise deficit was permanent, hovering around $US3 billion. Imports have regularly been three to four times larger than exports. The compensatory effect of hard currency inflows coming from a surplus on trade in services (tourism, communications, transportation) and from remittances, has been insufficient to cover the gap.

With the rationalization of the sugar industry, the trend in merchandise imports will decrease, thereby helping to reduce the merchandise trade deficit. Over the next five years, it is expected that the trend in import demand should no longer be boosted by tourism growth in the same way it was in the second half of 1990s due to an increase in import substitution helped by the transfer of sugar lands to food production, higher levels of domestic oil production, and improved energy efficiency, (The Economist Intelligence Unit, 2002:11). The export trend should also be reduced in the short term, perhaps to about one-half of the previous 11% rate in the second half of 1990s, given the recent hardening of financial conditions for short-term loans, as well as the effect of the world economic slowdown on tourism. As a result, growth in merchandise exports will overtake that of services exports—although this will occur at a slow pace.

The three main sources of Cuban income are tourism, remittances and the export of traditional commodities. Tourism accounted for 41% of total income in 2001, nickel 13.9%, and sugar 10.4%. Remittances (estimated in 2001 at $813 million) bring in a similar amount to the net income derived from tourism. And, while all have grown steadily during the “Special Period,” the sputtering Cuban economy has been consistently hampered by access to external financing. The bottleneck of the Cuban economy involves a lack of access to fresh and long-term credits, the low level of
financial integration with international credit institutions (e.g. the exclusion from IMF, WB and other international creditors due to the US veto), and limited access to capital markets as a result of the moratorium on Cuba’s foreign debt declared in 1986. Clearly these circumstances reduce the options for bilateral negotiations. Most of Cuba’s external debt stock (rounded at $US12 billion, without counting the debt with the former socialist countries of $US20 billion) consists of the principal and interest arrears of debt contracted before 1986, when a moratorium on debt servicing was declared. Concentrated in the former CMEA countries, Japan Spain, Belgium, Italy and the UK, the Cuban authorities have sought to reschedule this debt, but not too much progress is expected in the short term.

The composition of Cuba’s external financing today is short-term loans, many of which are likely to be secured against the revenue generated by sales of commodities or services. (EIU, 2002:11). Some renegotiations with Canada, Italy, Japan, U.K., and Spain as well as preliminary conversations with the Paris Club, have ended in a partial decrease in tensions. Part of the commercial debt with Japanese enterprises was rescheduled in 1998, while another agreement signed with Italy reopens both access to insurance for credits and another line of credits with preferential treatment supported with guarantees from the Cuban government and tourist income. All these helped to finance short-term commercial operations (two to five years) from 1997-1999. The main sources of debt today are bilateral government loans and credits for exports with government insurance, with $2.7 billion being the additional debt accumulated between 1992 and 1998.

Overall, then, changes in business culture, policymaking practices, and macroeconomic incentives and regulations have been the common ingredients of
Cuban reforms for a decade now. The naïve criticism in the early stages about a lack of coherence and complementarity between measures has given way to more pragmatic considerations. Economic rationality is subordinated to political atmosphere with an implicit “learning curve” for technocrats and politicians alike. Timing is as important as the perceptions and stereotypes that can also have an impact. Free Trade agreements are part of the international process of adaptation to new realities. Hence, sooner or later Cuba will have to find the way to either adapt or counterbalance their effects in light of the effectiveness of current reforms, but the rapprochement should not necessarily have to take place within the context of the agenda promoted by the US through FTAA, despite inevitable spillover effects. In fact, FTAA has a dual effect; on the one hand, it accelerates the process of regional and bilateral free trade agreements (which could have some effect on Cuba's current treaties by introducing pressures toward homogenization), while on the other, it stresses isolation without additional costs for the country. If the current conditions of the embargo change—due to any circumstance--such a development will bring about an important modification to the current international perception of the risk involved in dealing with Cuba.

The U.S. Shadow over Cuba’s Economic Relations

Throughout the 20th century and now into this, economic sanctions have been an important tool in U.S. foreign policy, but the cost of such policy has rarely been considered. The U.S. embargo against Cuba has been not only one of the world’s longest, but it has also ranked as one of the most severe in the world. Implemented
since early 1960, the adverse effects were to some extent compensated for the first two decades by economic assistance from, and preferential trade relations with, the CMEA. Official estimates (Aguilar, 1998; USITC, 2001:3-35) present an accumulated cost of this embargo in 1998 of $US67 billions, due to costs of trade relocation and general increases in the costs of production, services, travel, and financial operations.

Justification for the U.S. economic sanctions on Cuba has been changed over time. Initially these were related to Cuba’s preferential relationship with the Soviet Union as well as its support for revolutionary governments, wars of national liberation and guerrilla movements in Latin America and Africa. In the late 1980s, until 1989, the reason was mainly related to Cuba’s potential threat to the security of the United States as well as to that of other countries (Smith, W.1994). In the early 1990s, with the end of the Cold War and Cuba’s opening to joint ventures and management contracts with foreign firms, the issue of nationalized U.S. properties gained importance and the focus was shifted to the problem of compensation for the nationalized properties of U.S. nationals. In the early years of the 21st century, and in the wake of the bombing of the World Trade Center, “security” has again become the mantra employed by Washington in its quest against the “axis of evil.”

In 1993, 41 export licenses (valued at $US423 millions) to execute or implement contracts in the fields of agricultural equipment or products, charter flights, communications, pharmaceutical supplies, medicine, medical instruments and equipment, information materials, monetary transference services, food, telecommunications, entertainment, artistic work, and travel services were approved by the U.S Commerce or the U.S. Treasury Department. In 1995, more than $300
million in legal business took place between U.S. and Cuban companies and the estimated activity in the period from October 1994 to December 1999 was over $750 million. The trend has been growing consistently, through the mechanism of special licenses, and it occurred even though attempts were being made in the 1990s to tighten the embargo through two new instruments—the Cuban Democracy Act (CDA, also known as the Torricelli law) and the Cuban Liberty and Democratic Solidarity Act, known as the Helms-Burton law.

Few years after the CDA, it was evident that its inhibiting effect was being undermined by trade and investment from other regions that were helping to restore economic growth on the island. Consequently an attempt was made via the subsequent Helms-Burton law to expand the scope of restrictions to affect all alternative sources of financial and trade relations by creating a less secure business environment for all foreign investors and trading partners. The Helms-Burton law compiles and re-codifies the existing restrictions that formed the U.S. economic embargo, as well as establishing the possibility of lawsuits and imposition of travel restrictions against foreign companies or other entities that “traffic” in U.S. properties expropriated by the revolutionary government. It also extends to those Cubans who later became U.S. citizens the right to sue foreign companies over expropriated property. It was clear that the immediate consequences of the Helms-Burton Act would be the increase of the implicit “country risk” profile for foreign investors. It would also have an effect any negotiations concerning Cuba's foreign debt and its desire for short-term credits.

One of the consequences of these sanctions can be trade deviation. In other words, what can occur is that competitors of U.S. investors move in and capture
business when the United States imposes unilateral sanctions against Cuba. One study
of this phenomenon by the Institute of International Economics (IIE) involved more
than 26 countries subject to U.S. economic sanctions. Their conclusions indicate that
Belgium, Canada, France, Germany, Ireland, Italy, Mexico, the Netherlands, and Spain
all trade more with Cuba than expected given size, income, and distance variables
(Hufbauer, Elliott, Cyrus and Winston, -IIE-, 1997). In other words, the reinforcement
of the embargo has given an extra incentive to trade deviation instead of its main goal,
a reduction to critical levels.

In some cases the embargo can, of course, cause other countries to be hesitant
to trade or invest due to probable consequences resulting in costs difficult to measure.
The U.S. pressures to prevent foreigners from investing in Cuba has yielded some
results, for another study has found that the Helms-Burton law “has met with some
success, but missed its main targets” (Spadoni, 2001:23). The law has been
moderately effective in dissuading some foreign companies from entering or staying in
the Cuban market (mainly newcomers), but it largely failed to achieve its main short-
term and strategic goals, namely to hamper the process of economic recovery by
stopping or minimizing the flow of foreign capital and by making foreign firms
already operating in the island resign and move out. Overall, the balance sheet shows
that a flow of foreign investment continues to arrive, albeit with reductions in 2003.
One study pointed out that “The Helms-Burton sanctions are more significant for their
political than their economic effects. They target Cuba but aim at firms and officials of
our strongest allies. The sanctions add only a very small incremental impact on the
Cuban economy” (Schott, 1998)\(^7\)
Europeans threatened to counteract the Helms-Burton by invoking the dispute mechanism of the World Trade Organization, but later the demand was retired. Instead, an “understanding” (i.e., a sort of treaty without signatures) was reached whereby the EU withdrew its appeal to the WTO panel and in exchange the United States promised to postpone the application relative to punishment of foreign enterprises. Canadians also reacted, updating the Foreign Extraterritorial Measures Act (FEMA) from 1985 to allow the Canadian government to apply fines to those enterprises that disregarded Canadian law, instead accepting terms and obligations from foreign countries (such as the United States). Again, however, this has not been implemented.

In the final analysis, then, the embargo certainly imposes a heavy burden on the Cuban economy, but evaluations on its effectiveness with regard to its main goals as well as its economic impact on the United States show that there have also been negative side effects closer to home. Ironically, the embargo has provided a special incentive toward trade and investment relocation with European and Latin American nations that in the absence of these constraints will be hard to achieve, the result being a process of restructuring of international economic relations without the burdensome pressures from U.S. multinationals.

**Perspectives about International Integration: Global Forces, National Politics**

The world today cannot escape from the fundamental ideology favorable to free trade in goods, services and capital, where the dominant role by far is played by financial capital. Far from the dynamic areas of financial circuits, the threat of the U.S.
policy of isolation to Cuba’s connectivity is basically associated with bilateral trade agreements and short-term financial arrangements signed with a high degree of risk. The government policy of restructuring its international economic insertion is subordinate to the maintenance of Cuba’s social gains and economic stability. Therefore, aperture and regional/global insertion are not goals by themselves, but rather are subordinated objectives of the general economic reform.

Central American and Caribbean countries benefited from special and differentiated treatment through generalized systems of preferences. For example, the Caribbean Basin Initiative and the agreement with the European Union contain provisions to maintain extensions (within the WTO framework) of export subsidies and of special conditions negotiated in free trade agreements. However, “empirical evidence suggests that this asymmetry didn’t help in a significant way to accelerate development of Central American economies” (ECLAC, 2001, No.507: 1)

There are three consequences of special and differential treatment that are of particular relevance for Cuba: a) it generated incentives to expand and consolidate the segmentation of markets and dual exchange rates with a growing disarticulation of links between domestic industries; b) it could induce excessive dependence of export and investment needs from the level of consumption instead of real capacity; and c) it reinforces short-term goals of economic policy.

The current Cuban regime of trade is compatible with WTO multilateral obligations. As with the rest of Caribbean and Central American countries, there are strong similarities in the profile of trade relations and structural asymmetries with developed countries. The challenge ahead is to evaluate the long-term viability of current domestic policies, in order to support the proper export promotion.. The
critical element in not the introduction of incentives needed to reactivate exports and
domestic economic activity, but rather the definition of mechanisms to dismantle
progressively these distorting structures of incentives.

One of the most complex challenges has to do with the potential relationship
for Cuba with the Free Trade Area of the Americas (FTAA). The concept of this
regional trading bloc was proposed at the First Summit of the Americas held in Miami
in December 1994, with the objective to reach an agreement by the year 2005 on a
schedule for the elimination of barriers to trade in goods and services and restrictions
on investment among the thirty-four countries of the Americas, excluding Cuba.
Negotiations were launched in April 1998 at the Second Summit of the Americas and
talks have begun in the negotiating groups.

The structure of negotiations around the FTAA is probably the most illustrative
of the many concerns held by regional observers. Latin America has historically
tended towards regionalism as a means to balance the power and the economic,
political and cultural influence of the United States. The precedent for the FTAA is the
North American Free Trade Agreement (NAFTA), between the United States, Canada
and Mexico. It is curious to see how in the early years of NAFTA the debate about
fast track in the decisive vote at the House of Representatives produced a conflict
inside the United States between proponents of world integration and the doctrine of
isolation. President Bill Clinton then described NAFTA as a “battle of ideas,”
stressing the inseparable nature of links between foreign and domestic policy in a trade
strategy tailored not only for the northern hemisphere, but also as a key component for
a global perspective. The geoeconomic base of this approach is the establishment of a
North American base to preserve the long-term capacity to compete with Asia and
Europe by promoting coordinate relationships that can be cooperative as well as competitive and by generating linkages more functional to new world tendencies instead of the traditional “host nation” scheme (Henrikson, 1995: 155, 161, 178).

The FTAA is an irreversible process that will bring both challenges and opportunities. Weaker and unbalanced countries have more to lose, but it is also true that marginalization will bring probably higher costs. The implementation of the FTAA will not bring significant changes in the current situation of Cuban trade insertion in the hemisphere. The costs for exclusion from the FTAA are in fact overcome by the results of Helms-Burton and the accumulated effect of the embargo for almost five decades. In practice, the FTAA would not modify the current conditions of competitiveness or access to markets due to the absence of “normal” economic relations with the United States.

But in the final analysis, neither the FTAA nor the Helms-Burton will be the ultimate determinants in the Cuban history of survival to adverse conditions. The reinsertion into world and hemispheric economic relations will continue with or without the U.S. consent. Perhaps one of the most important challenges is not the accommodation of the current structure of trade relations to future changes, but rather the preservation of strategic competitive advantages that could be undermined by pressures to converge toward the regional pattern of specialization in tourism and the maquila structure. The most important lesson from Latin American experiences in reforming trade relations is that commerce is not a goal in itself, but is part of a wider strategy to overcome dependence and underdevelopment.
Cuban Regional Integration

Canada is one of the most important partners for Cuba. It, was example, the principal source of tourism in 2002 with 344,468 visitors. Overall in 2002 it represented 9.2% of Cuba’s total trade (590.2 millions of US$), occupying second place as a destination for Cuba's exports 13.7% (227.8 mill.) and fourth place as a source of imports 7.6% (362.4 mill.). Canada is also the second largest investor with 72 joint ventures reported in 1999, with important projects in mining, energy, gas, communications, airports, and tourism related-enterprises.

Unfortunately there has been a basic instability in volumes and content of trade, a trend which has been the dominant factor in this bilateral exchange. In the 1980s, cereals and food were the main exports, while in the 1990s there was a shift toward manufactured goods, machinery, chemicals and agricultural equipment. The level of exchange has been dependant on such factors as the prices of primary products (sugar), the evolution of Cub's foreign debt, access to credits and capacity of payment, and political circumstances (Sánchez-Egozcue, 1999: 13).

While the role of Canada has become increasingly important in the 1990s, there is no denying that the natural trading partner of Cuba is the United States. Before the revolution, for example, Cuba's economic relations were characterized by an absolute dependence on the United States. At the end of the 1950s, for example, 70% of Cuba's total trade in goods, approximately $1.5 billion, was with the United States (67% of Cuban exports and 70% of imports). In 1960, 65% of Cuba’s imports and 58% of Cuban exports were also with the United States. Several Cuban imports were absolutely dominated by U.S. business–e.g. 98% of powdered milk and 100% of wheat, corn and animal food. In tourism, 85% of visitors were U.S. citizens and 41%
of the country's total FDI ($861 millions in 1958) was American. Shortly after the revolution, however, political disagreements and the embargo sharply reduced trade relations until the early 1980s when the Treasury Department was authorized to issue special licenses for trade and a modest but steady increase developed through subsidiaries located in third countries—principally Switzerland, Argentina and Canada. With the disappearance of the socialist bloc, trade with U.S. subsidiaries quickly rose to over $US700 million (mainly in medicine and food)—until the Torricelli Bill (CDA) put an end to this form of relations.

Several studies about the potential of bilateral US-Cuban trade relations have estimated a gross potential of around $1 to 2.6 billion in the first year of resumption of bilateral trade. One of the most comprehensive evaluations is that of the U.S. International Trade Commission (USITC). Despite the conservative assumptions, its estimate was for 7-15% ($US69-146 m.) of Cuban exports and 17-27% ($US658-1047m) in imports would be with U.S. companies, for a total bilateral trade of $US512-978 m. The current trade between the two countries has been extended on a cash-only basis, which makes Cuba, paradoxically, one of the safest markets for U.S. companies because of an absence of risk. By early 2004, more than $US500 million worth of food had been purchased from U.S. producers by Cuba. This topic is dealt with in some detail by Soraya Castro and Philip Brenner in their chapters.

The Role of Latin American Trade Relations with Cuba

The composition of world trade has changed in the last decade, with the most dynamic export areas being electronic products and those related to communication
and information technologies. In contrast, primary products have been losing market share. Latin America and the Caribbean show three differentiated patterns of export specialization: one characterized by the growing participation of dynamic products (México and several countries from Central America and the Caribbean); a second where products with an intensive use of natural resources prevail (South America); and a third of specialization on services exports (tourism and finances, as is the case with the Caribbean nations.

In 2001, Latin America represented 30% of Cuba’s foreign trade as opposed to 1990 when the level was barely 5.3%. The average exchange from 1990-2001 was 31.2%. Integration with the south is particularly important through the Latin American Integration Association (LAIA/ALADI), which was replaced in 1980 by the Latin American Free Trade Agreement (LAFTA/ALALC), founded in the early 1960s for the South American countries and Mexico. Within LAFTA, the reduction of tariffs and other barriers were negotiated on the basis of product lists. Members give priority to regulate economic specialization by agreement rather than the market. LAIA now is primarily structured around bilateral trade preferences with less ambitious programs of integration. Cuba entered the group in 1998 through agreements of Economic Complementation signed by all members. Since then, LAIA is by far Cuba’s most important regional partner, and within Latin America, LAIA represents around 70% of Cuba’s regional trade. In 2001, trade with members of this group amounted to 25.4% of Cuba’s total commerce, and from 1990-2001 trade average was 17.5%. In the 1990s, the evolution of Cuban commercial relations with ALADI showed a notable growth but, because they were mainly imports, the commercial deficit also rose
elevenfold. The resulting pattern is totally asymmetric, with a high level of trade but with a similarly high deficit.

The second level of integration--with Central America and CARICOM--is almost irrelevant, representing approximately 2% and 6.5% respectively of Cuba's total Latin American trade. The Central American Common Market (CACM / MCCA), is an arrangement oriented to production-sharing which has been only rarely implemented. Members have been negotiating together, but signing and implementing separately. In 2001 CACM captured only 0.7% of Cuba’s total trade, with 0.8% as an average for 1990-2001. At the hemispheric level, CACM represents only 2% of Cuba’s trade.

In 1973 the Caribbean Community and Common Market (CARICOM) replaced the Caribbean Free Trade Area (CARIFTA--founded in 1968). Trade between members was extremely limited because of the islands' extreme dependence on tariff revenues and similarities of exports. CARICOM interests are divided between negotiations with the European Union to preserve privileged market access through the Cotonou agreement and with the U.S. market. Although the ACP’s Caribbean group has lobbied in Cuba’s favor, Cuba remains outside the Cotonou agreement, despite being an associate member of the ACP. The appearance of NAFTA on the scene has resulted in a constant erosion of the commercial preferences enjoyed by Caribbean nations under the Caribbean Basin Initiative (CBI). The NAFTA liberalization of tariff and investments has favored Mexico, with strong deviation effects on trade and investments. Efforts to promote some extension of the CBI to balance the loss of share on the American market have been useless. CARICOM has a strategic dilemma--foreign trade is by far more relevant than intra-regional trade, but
because similarities in exports between members leave low benefits resulting from this trade, as a group they have to convey more value on their transactions with the European Union and the United States than on the promotion of a free trade area between neighbors. Trade between Cuba and CARICOM was 0.7% of Cuba’s total commerce in 2001 and accounted for an average of 0.8% in the period 1990-2001.

The rest of Latin America links are largely irrelevant as far as Cuba is concerned. Mercosur and the Andean Pact represent together less than 2% of Cuba's trade. The special case, of course, is Venezuela, with a shift from low participation in previous years up to 15% of Cuba’s total trade in 2001, mainly due to oil deliveries.

In summary, LAIA is the dominant actor in Cuba’s commercial relations with Latin America, with 70% of the country’s regional trade, and accounting for a quarter of total Cuban trade. This exchange is, however, unbalanced, with a high penetration of LAIA exports and a low import level from Cuba. Prospects for further integration inspired by parallel arrangements with the “transference” of “free trade” rules or any kind of convergence with an ongoing process of regional liberalization are limited due to: a) the nature of LAIA, based on bilateral agreements concentrated on product selection instead of a set of rules; and b) the character of the relationship with Cuba, dominated by a growing deficit.

Cuba’s Trade Relations with the Caribbean Basin

The average of total trade between Cuba and CARICOM from 1990-2001 was barely 1.1% of Cuba's total trade. Lower tariffs and facilities for investment could perhaps increase these numbers two or three points, but it will not change the limited significance of the region in Cuba’s international commerce, at least for the medium
term. The main limitation is not the political environment; since the region is the most supportive organization of Cuba’s full economic reinsertion into the hemisphere. But the similarities in export profiles and import needs leave few opportunities to increase trade within the region. Cooperation in tourism, transportation, and communication are the most promising areas.

**Cuba-European Union Trade: The Limits of Constructive Engagement**

After the Soviet collapse, western Europe gained in importance in Cuba due to the relocation of trade and financial relations. Trade with the former socialist bloc was reduced to around 15% within a few years. The remaining links were somehow consolidated at the end of the 1990s, as political relations with Russia and the Ukraine improved, but there is little expectation that this will increase. Today the European Union (EU) is the largest partner of Cuba in commercial relations, assistance and investment. Since 1993, the EU has provided 145 million Euros (167 million US$) in assistance and early in 2003 an office was opened in Havana to administer the 15 million euros (16.4 million US$) annually offered. Trade, investments and tourism flows have been growing for over a decade, despite the relative lack of support at official levels.

In the early 1990s, European economic assistance was assigned under the concept of “humanitarian help” for a country in the midst of a profound crisis. This approach changed in the mid-1990s to a broader one of “economic cooperation,” indicating a change in perceptions from a need for short-term assistance toward programs of support for reforms. This change occurred once it became clear that the
government remained in political control and economic change was underway. Another important factor was the realization that economic recovery was only possible with foreign resources.\footnote{Since then, economic ties have developed with European entrepreneurs without a formal agreement for economic collaboration with the EU (mainly through bilateral negotiations). The Cuban relationship with the EU depends upon three key factors—the role of the United States, commercial interests, and the internal situation of Cuba. This latter point is dealt with in detail in Joaquín Roy’s chapter.} Relations between the United States and the EU are based upon a mix of competition and collaboration. The economic degree of interconnection is important, with each representing the main economic partner (& rival) for the other. However, there are also frictions, particularly on the commercial side as illustrated by the case of claims at the WTO regarding subsidies and regulations over agricultural commodities, manufacturing and food.

In the particular case of Cuba, the EU is the island's main commercial and financial partner as well as its second most important source of tourists. Trade in goods with Europe in 2001 was 43.4% (of which EU countries account for 33.6%) of Cuba’s total trade, with the average for the period 1990-2001 being 26.6% (the second on the list, Latin America, had an average of 23.7%). Total European imports represented 35.1% (from that figure, the EU countries accounted for 31.3%, with Spain, Italy and France as the leading partners) of total demand, and exports from Cuba were 67.3% of the total (40.3% for the EU).

Regardless of the importance of trade with this area, a better agreement with the EU should not be the core of Cuba's commercial strategy. While a more active
Cuban role in the world economic system would be facilitated by better relations with the EU, the solution of the island's current tensions with regard to its balance of payments are not limited to trade access and support for credits, but rather are dependent on wider considerations, fundamentally those of a domestic nature.

**Conclusions**

The transformation of the Cuban economy in the 1990s in response to the implosion of the socialist bloc represents a drastic rupture in a model of international insertion. For thirty years this had been based on the specialization of exports in primary commodities (sugar, citrus, mining), much of which was concentrated on the market of the Soviet Union. The Cuban economy became highly subsidized through the preferential treatment shown the island economy by CMEA members. With the sudden disappearance of this model, the country was forced to reorient trade and investment flows into world markets as part of an overall process of economic reforms aimed to reduce the impact of the shock and simultaneously to reconstruct the entire economic structure. The reinsertion into world markets has exposed the significance of structural limitations, reinforced by the U.S. embargo, that reduce substantially the possibilities for short-term recovery to pre-crisis levels of economic activity. However, the wide economic opening seen in the last decade, the intense process of import substitution, the massive dollarization of domestic transactions, a contractive fiscal policy and the shift from primary commodities toward tourism have been key components of a successful strategy to stop the fall and recover macroeconomic stability and growth with higher levels of productivity and dynamism, fundamentally in the areas related to foreign relations.
The current pattern of international insertion is completely different from its predecessor, with a noticeably higher diversification in markets, changes in the structure of exports (e.g., services prevailing over primary commodities and new areas such as vaccines and software with higher value-added technological content) and of imports (e.g., substantial reduction of dependence of imported oil for domestic generation of energy), as well as new factors (i.e., significant inflows of remittances, a growing wave effect of tourism, monetary duality, and segmented markets) and increasing trade (despite extreme restrictions) with the United States.

A more dynamic international insertion depends on the degree of competitiveness in expanding trade and investment. This is seriously limited by several factors: a low level of domestic resources, high foreign debt and country risk profile, limited access to markets and financial resources exacerbated by the U.S. embargo, and an overvalued exchange rate that represents a distorted incentive to increase imports and compromises the potential of export producers. These “strategic constraints” suggest a scenario of continuity of the current structure of international insertion in the midterm because changes in critical variables (negotiation of the foreign debt, relaxation of tensions with the EU, softer terms of credits, lower country risk, changes in access to the U.S. market) seem unlikely in the short / mid term.

The current model of international insertion has elements of convergence with trends within the region (Caribbean Basin and Central America) such as a specialization in services (tourism) and some manufacturing, but factors such as a lack of access to the U.S. market, the “distorted” structure of market allocation and the low relative weight of intra-regional trade make divergences more significant.
The geographic structure of integration currently gives priority to the European Union as the main commercial and financial partner as well as the second source of tourism. Prospects for multilateral expansion of trade and investments through the Cotonou agreement have been canceled due to recent political tensions, leaving bilateral arrangements as the only path to continue trade relations. Second in proportion of trade is Latin America. At the regional level, the Latin American Integration Association (LAIA) is by far Cuba’s most important regional partner. The Central American Common Market (CACM / MCCA) and the Caribbean Community and Common Market (CARICOM) each represent at the regional level only 2% of Cuba’s trade. Prospects for further integration inspired in parallel arrangements with “transference” of “free trade” rules or any kind of convergence with ongoing process of regional liberalization are unlikely.

The most likely basis of international trade for the foreseeable future are bilateral agreements based on preferences for selected products, with or without government-to-government insurance. Other forms of integration in the hemisphere, (FTAA, bilateral FTA or subregional treaties) will have little impact, particularly in regards to South America. The potential for trade expansion in the short term is associated with better access to credits, not with changes in the current structure of exports. Tourism will continue its role as the leading force, while exports in the manufacturing sector and commodities with more technical and human capital content depend on improved market access through bilateral negotiations. Investments are not expected to expand significantly over current levels because of the threat from the U.S law.
The factor with most potential to modify this picture significantly would be a change in the current constraints on U.S. entrepreneurs and potential visitors. Despite the firm opposition from the President George W. Bush, pressures of anti-embargo lobbyists, particularly from inside the Republican Party (i.e., agricultural producers, food and tourism related industries, medicines and medical equipment manufacturers) could in a reasonably short time (e.g. some 2 to 4 years) introduce changes to the present conditions. If this happens (even without changes in the current cash-only payment requirements), it would represent a fundamental shift in the current Cuban model of international insertion.

NOTES

1 Estimates vary because of problems derived from the use of different systems of national accounting, and price-setting mechanisms. Socialist countries apply the “material production” or “Global Social Product” which differs from the conventional international accounting system. The U.S. government has take as reference a figure nearly 6 billion annually in late 1980’s, see, U.S. Department of State, “U.S. Cuban Relations” at www.state.gov/regions/wha/cuba/policy.html

2 "The loss of East European markets and lower deliveries of Soviet oil after August 1990 caused a generalized crisis for the Cuban economy. With foreign exchange cut by around 80%, shortages of inputs, spare parts and capital were acute. The economy contracted by 34% from 1990 to 1994." (Economist Intelligence Unit Country Profile, 1996-97, 11) As a result, by 1992 the value of total trade turnover (exports plus imports) between Cuba and the former Soviet bloc countries had fallen to only $830m,
or roughly 8% of its 1989 level." (See The Economist Intelligence Unit Country Profile, 1996-97, 34)

3 Between 1988 and 2000, more than 540 international economic associations were created, of which 374 remain active (Pérez Villanueva, 2001:8)


5 Sugar exports counted for over 75 percent of Cuban foreign currency earnings in 1989, and less than 20 percent in 1996. In 1996, international tourism earned the most hard currency ($1.35 billion), followed by sugar ($970 million), family remittances (estimated at $500 million), and nickel ($417 million). (Journal of Commerce, 25 August 1997, 5A)

6 According to the Office of Foreign Assets Control (OFAC) of the United States Department of the Treasury in Washington, D.C., “In the mid-1970’s, Section 515.559 was added to the Regulations to allow OFAC to license foreign subsidiaries of U.S. firms to conduct trade in commodities with Cuba so long as several specific criteria were met.” U.S.-Cuba Trade and Economic Council, Inc., www.cubatrade.org


8 An insightful observation is perhaps appropriate here: “in Cuba, it is wise not to underestimate the power of politics over the power of economics. After all, if Cuban
society reacted in a “normal” way to economic pressures, the Revolution would have crumbled some time ago.” (Gillian Gunn Clissold, 2002:7)


10 2003 commercial highlights, www.cubatrade.org


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