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Cuba: Economic Performance, Policy, and Prospects



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An Intelligence Assessment

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*ALA 86-10044
October 1986*

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Cuba: Economic Performance, Policy, and Prospects



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An Intelligence Assessment

This paper was prepared by 
 the Office of African and
Latin American Analysis. It was coordinated with
the Directorate of Operations 

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**Cuba: Economic Performance,
Policy, and Prospects**

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Scope Note

This paper is the fourth in a series of assessments produced during the past year that have examined shifts in Cuba's economy and their impact on domestic and foreign policies.

[Redacted]

This study provides an assessment of Cuba's five-year plan for 1986-90, and, with the help of a computer-based econometric model, explores the outlook for Cuba's economic performance over the next five years.

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**Cuba: Economic Performance,
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Key Judgments

*Information available
as of 20 September 1986
was used in this report.*

We believe there is little prospect for significant improvement in the Cuban economy at least through the remainder of this decade. Although the newest economic plan—for 1986-90—places a greater reliance on market mechanisms to enhance economic performance, we doubt that Castro will permit more than token implementation of proposals that employ capitalist incentives and thus offend his revolutionary principles. Moreover, largely because of its own economic difficulties, Moscow is unlikely to increase substantially the level of its economic assistance to Havana. As a result, the Cuban population almost certainly will become increasingly restive and disenchanted as hopes for a better life fade. Over the short term, this may lead the Castro regime to allow another mass emigration to the United States. Over the longer term, as economic problems build, Havana is likely to attempt to expand its hard currency income by various means, such as increasing its efforts to evade the US trade embargo and trying to garner additional civilian assistance contracts in the Middle East and Africa.

[Redacted]

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We doubt Cuba can overcome its shortages of hard currency—largely due to its dependence on sugar and oil earnings and lack of alternative exports. Lower world oil prices will have a particularly damaging impact because Havana has relied on the reexport of Soviet oil for more than 40 percent of its foreign exchange earnings. Sugar earnings are also likely to stagnate, and Havana probably will make little progress in diversifying its export base. Moreover, low labor productivity caused by growing worker discontent is also likely to hold down exports. Complicating Cuba's hard currency woes, Western lenders are likely to be more cautious in rescheduling Havana's existing debt or advancing new funds. [Redacted]

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Under these circumstances, Havana will fall short of its target of 4- to 4.5-percent average annual growth for 1986-90. Using a computer-based econometric model of the Cuban economy, we estimate that economic growth probably will average only 2.2 percent a year over this period. Moreover, unplanned events, such as a reduction in Western credit or Soviet aid, could lead to serious economic dislocations. Under these scenarios, likely import and investment cuts would weaken Cuba's industrial base significantly, further depressing its long-term economic growth prospects. [Redacted]

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The Soviets have promised little relief for Cuba over the next five years. Recent bilateral trade and economic cooperation agreements fixed oil and sugar trade during 1986-90 at 1985 levels. Although the Cuban press reported that the USSR had agreed to increase industrial development credits by 50 percent, these credits account for less than 10 percent of Moscow's total economic assistance package and will have a limited impact on the Cuban economy over the short term. [Redacted]

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To compensate for the drop in hard currency earnings, the Cubans may attempt to increase their moneymaking overseas projects—especially in the Middle East and North Africa. However, declining oil revenues have also slowed the economies in many of these countries. Havana may also step up efforts to acquire Western technology to improve productivity and efficiency. Castro may even reconsider the ban on travel by Cuban-Americans to boost tourism earnings, depending on how he weighs the benefits against the political considerations. We doubt, however, that Castro will make the fundamental concessions—such as renouncing his commitment to violent revolution—necessary to better relations with the United States. [Redacted]

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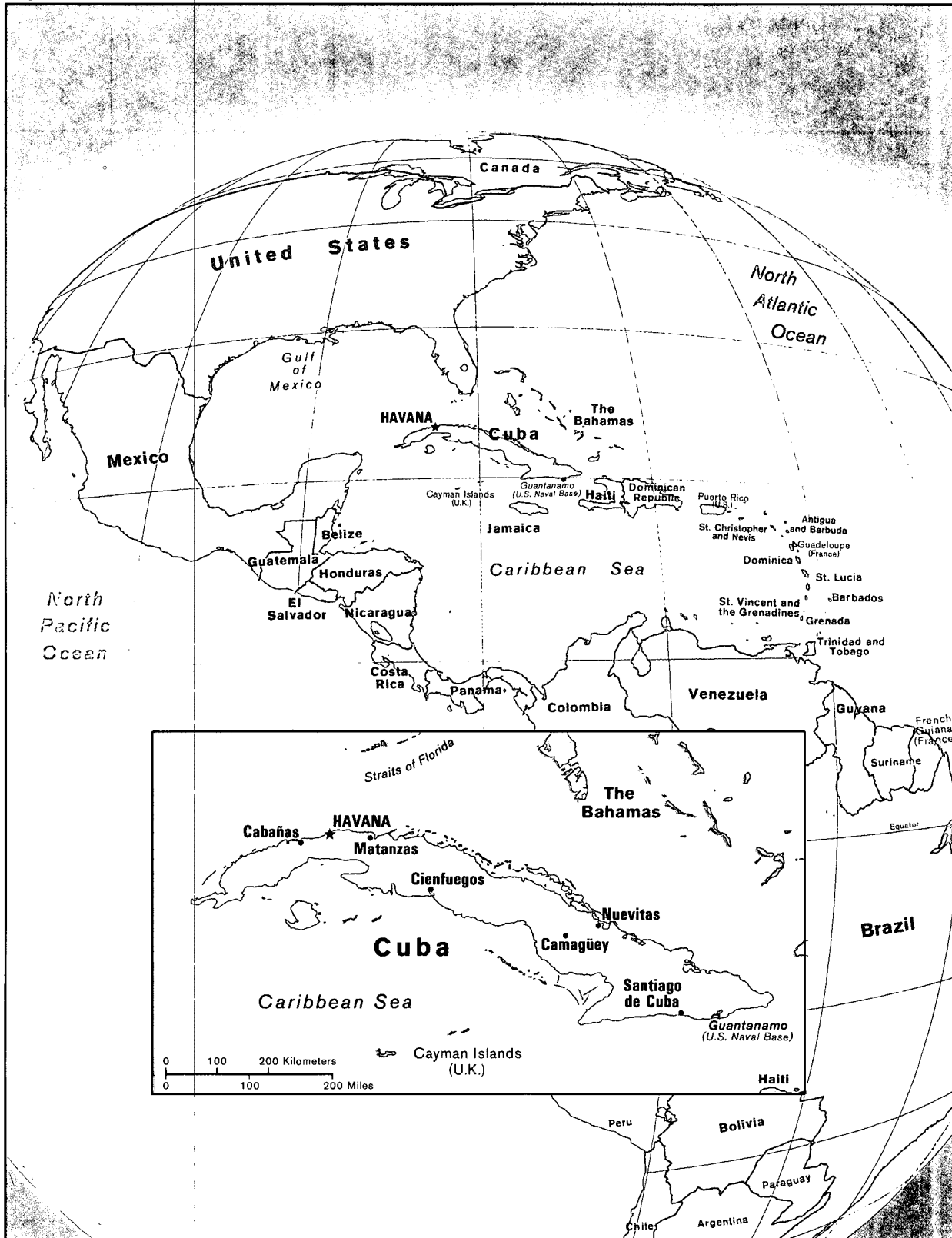
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Figure 1



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**Cuba: Economic Performance,
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Introduction

In late 1984, growing Soviet dissatisfaction with Cuba's poor economic performance apparently forced President Fidel Castro to sharply redefine his economic policies. During 1985, the Castro regime intensified economic austerity, instituting measures built around consumer sacrifice and energy conservation. In addition, several key economic officials in the bureaucracy were replaced. At the Cuban Communist Party's Third Congress in February, President Castro presented for formal party approval a five-year plan for 1986-90 designed to resolve the problems hindering the nation's economic development. [Redacted]

- To "absolutely guarantee" fulfillment of Cuba's commercial and financial obligations to CEMA.
 - To improve the standard of living.
- To implement these objectives, the new plan outlines specific targets for key components of the economy's performance, including:
- Imports are to increase less than exports.
 - Labor productivity is to grow by 3 percent annually.
 - Sugar production is to increase by 20 percent compared with 1981-85 output.
 - Gross Social Product³ is to grow by 4 to 4.5 percent annually. [Redacted]

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Emphasis on Market Mechanisms

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This paper discusses the major policy initiatives of Cuba's new, five-year plan, which features an emphasis on profitability and efficiency as well as decentralization of decisionmaking, and examines the plan's ambitious goals and key vulnerabilities. The paper then explores what is in store for the Cuban economy through the rest of the decade—based, in part, on the analysis of a computerized model of the Cuban economy—and discusses the implications for the United States. [Redacted]

The apparent strategy for achieving these goals will be a shift toward the use of market mechanisms to help solve pressing economic problems. The plan thus gives special emphasis to increasing the role of prices, reducing rationing, using material incentives to motivate the labor force, raising enterprise profitability, and decentralizing decisionmaking. [Redacted]

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The plan states that the pricing system should be improved in the areas of measuring, stimulating, and redistributing national income. Havana probably hopes that an enhanced role for prices will improve resource allocation, reduce production costs, and increase product quality. The pricing reform seems directed solely at wholesale prices; [Redacted] Havana informed its Paris Club creditors last year that wholesale prices were to rise by 35 to 40 percent between 1986 and 1990. [Redacted]

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A New Commitment to Economic Liberalization?

Cuba's 1986-90 economic plan formalizes many of the themes discussed by the country's leadership since its so-called declaration of economic war in late 1984.¹ The draft plan,² first released in November 1985, sets out three fundamental objectives:

- To increase hard currency earnings by \$1 billion annually—roughly double current levels.

In the area of rationing, the plan proposes a related move to reduce rationing and increase the number of products sold on the less subsidized parallel market.

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³ The Gross Social Product is equal to the sum of the value of the gross production of all production sectors. This indicator does not include the value of services such as housing, health, education, and defense. [Redacted]

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[Redacted]

² [Redacted] we think the draft released last fall is largely representative of the plan approved at the Congress. We base this conclusion on reporting by the Cuban media on the five-year plan as well as on related resolutions approved at the Congress. [Redacted]

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According to Cuban statistics, rationed goods currently account for some 31 percent of consumer expenditures on goods and services. Growing Soviet displeasure with Cuban rationing [redacted]

[redacted] probably played a large part in Castro's decision on this score. [redacted]

Labor incentives such as bonus pay and premiums are also given prominence in the new plan, which states that "economic incentives should become a real lever by which enterprises can promote worker efficiency." This provision of the plan seems to strengthen the present system of incentive payments established in 1981, under which bonuses are given to workers for improvements in product quality and output for export, conservation of fuels and other raw materials, and general enterprise performance. The new proposal calls for bonuses to be paid for performance over periods of less than a year to more closely tie rewards to results, and to use incentives to promote the application of new production technologies and new product development. [redacted]

The plan also demands an increase in enterprise profitability, which is to be the "fundamental and decisive" indicator of efficiency. It calls on unprofitable enterprises to become so by 1990, and states that only "superior levels of the government" can grant exceptions from this goal. We believe Cuban workers could bear much of the brunt of any cost cutting if enterprises trim their staffs to become more profitable. Havana already has bluntly indicated that administrative payrolls should be tightened to "eliminate excesses." [redacted]

The regime's plan also envisions that decentralization of decisionmaking and streamlining of the bureaucracy will stimulate efficiency and innovation. According to a resolution approved at the Third Party Congress, enterprises should be permitted "real economic and operational autonomy, and be free of controls which limit their decisionmaking initiative." [redacted]

Problems in Achieving the Goals

In our judgment, the plan is destined to have only a marginal relevance to Havana's economic policy making and performance in practice. We doubt that

implementation of the plan will go beyond token gestures. We believe the plan is designed only for the benefit of Cuba's creditors in Moscow and the West, and does not have the support of key decisionmakers, including Fidel Castro. Even if the leadership were fully committed to the program, we doubt that the goals of the program are achievable as presented:

- The plan's emphasis on profitability, material incentives, and decentralization runs counter to the regime's deeply held antipathy for anything approaching free market mechanisms. Over the years, Castro has repeatedly taken offense at the "materialistic behavior" resulting from experiments employing profit incentives. Castro has criticized directors of state enterprises repeatedly in recent speeches for "playing with capitalism," and urged managers to rely more on political education to motivate workers. Over the past several months, Castro has abolished the farmers' free markets, tightened the recent housing reforms that permitted private sales and ownership, and lambasted salary and bonus incentives for encouraging corruption and capitalist practices.

- As with previous five-year plans—Cuba's performance has been dismal in all of them (see table 1)—the current plan has serious flaws. We view as unrealistic, for example, Havana's intention to significantly expand exports to the West while simultaneously satisfying CEMA demands for increased Cuban goods and maintaining steady domestic consumption levels. We also believe Cuban planners failed to take into account problems such as low worker productivity, cyclical swings in commodity prices, or the likelihood of agricultural disasters.

Despite these problems in the design of the plan, efforts to implement free market approaches and managerial autonomy would probably somewhat improve the performance of the economy, particularly since more pragmatic and better educated administrators have been moved to key economic ministries. Even so, Castro's perennial tilt toward ideological imperatives and away from experiments with free

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Table 1
Comparison of Production Goals With Actual Performance

Thousand metric tons
(except where noted)

	1980 Goal	Percent Achieved	1985 Goal	Percent Achieved ^a
Agriculture				
Export crops				
Sugar	8,000-8,700	85	10,000-10,500	75-80
Tobacco	60	55	55	66
Citrus	350-550	53	1,300	57
Coffee	NA	NA	46	55
Seafood	350	42	NA	NA
Domestic crops				
Rice	600	65	630-640	78-80
Milk	1,000	79	1,100-1,300	60-70
Pork	80	76	85	106
Beans	NA	NA	35	11
Eggs (<i>million dozen</i>)	167	100	192	100
Industry				
Nickel	100	32	69	49
Steel	440	74	1,800-2,000	20-22
Electric power (<i>billion kilowatt hours</i>)	9.0	110	NA	NA
Cement	5,000	46	4,900	62
Textiles	260	58	325	62
Shoes (<i>million pairs</i>)	35	51	29	40
Refrigerators (<i>thousand units</i>)	100	55	NA	NA
Radios (<i>thousand units</i>)	300	48	NA	NA

^a Estimated.

Sources: Various issues of *Anuario Estadístico de Cuba*; various National Bank of Cuba publications

[REDACTED]

marketing—even when such experiments are successful, as was the case with the farmers' free markets—will, we believe, undercut any efforts by the ministers to move according to the five-year plan. [REDACTED]

Outlook for 1990: No Blue Skies Ahead

With the help of a computerized model of the Cuban national output, we examined the relative impact of

what we believe to be the three most likely scenarios for the Cuban economy (see appendix B):

- Our baseline scenario assumes that existing constraints will remain essentially unchanged for the next few years; Soviet aid will remain at current levels, labor productivity will continue to lag, and Western creditors will agree to finance only a portion of Cuba's hard currency account deficits.

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The Role of Soviet Economic Assistance

Havana is dependent on Soviet economic assistance to meet its basic consumption and investment needs. We estimate that Moscow provided some \$38 billion in economic assistance to the Castro regime between 1961 and 1984. A large part of this assistance—about 70 percent—consisted of nonrepayable trade subsidies representing the difference between the prices Moscow pays or receives in its trade with Cuba, as compared with world market prices. For example, in 1984 Moscow paid about 10 times the world market price for Cuban sugar and charged Cuba a little less than the world price for its petroleum shipments. Only about \$11 billion of the total Soviet assistance provided during the time frame represents true economic aid such as technical services, project aid, and loans to cover Cuban trade deficits with the USSR. This aid is repayable, but the Soviet Union has deferred any repayment until at least 1990, and then at only nominal interest rates (see appendix A). [redacted]

Moscow's economic assistance has ballooned in the 1980s, amounting to some 60 percent of the total assistance extended to Cuba since 1961. Most of this increase is due to the tripling of Moscow's sugar subsidy to help Havana cope with the precipitous decline in world sugar prices and falling oil subsidies. Although much greater than the levels of the 1960s and 1970s, Soviet economic aid has remained relatively stable throughout the 1980s, possibly reflecting Moscow's desire to limit the size of its investment in Cuban agriculture and industry. The Soviet petroleum subsidy has declined dramatically in this decade, however, as the Soviet price to Cuba—calculated as the average of world market prices over the previous five years—approached the world price (see appendix A). [redacted]

During the 1981-85 five-year plan, Moscow encouraged Cuba to conserve oil by allowing it to resell the oil it saves for hard currency. For example, although Moscow pledges to provide Cuba about 210,000 b/d, we estimate Havana currently uses only about 130,000 b/d and resells the remainder. On the

basis of public statements from Cuban officials [redacted] we believe Havana cut its consumption of Soviet oil by 25 to 35 percent between 1980 and 1985. Havana was thus able to earn a substantial portion of its total hard currency revenues during the period from this source. Since 1983, oil resales have surpassed sugar as Havana's leading hard currency export, and Moscow has permitted Havana to continue this arrangement at least through 1990, [redacted]

Havana is dependent on Soviet oil supplies to fuel the economy—Soviet oil accounts for about two-thirds of Cuba's total energy consumption—and will continue to be so through at least the remainder of the decade. The industrial sector—especially the important nickel industry—is almost totally dependent on Soviet oil supplies. The sugar industry is more independent because it meets much of its energy needs through the use of bagasse, a byproduct of sugarcane. While domestic oil production has grown steadily over the past few years, it accounts for only about 10 percent of Cuba's total oil consumption, and there are no significant hydroelectric, coal, or natural gas resources in Cuba. [redacted]

A nuclear power plant is under construction at Cienfuegos that Havana claims will reduce Cuba's oil consumption by 2.4 million metric tons—by more than one-third of current consumption. Construction, supervised by Soviet engineers, is well behind schedule, however, and the facility will not be operating until the early 1990s. Two additional plants are also planned for the western and eastern parts of the island. Moscow is supplying at least two, and possibly four, nuclear reactors for the Cienfuegos plant and has also trained Cuban technicians and provided a research reactor. [redacted]

Moscow is assisting the Cubans in expanding their domestic petroleum production by building new refineries, by constructing a supertanker port at Matanzas

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in central Cuba, and by exploring for petroleum both offshore and onshore. Cuba's three existing oil refineries are being modernized with Soviet assistance, and the construction of the first stage of a \$345 million refinery in Cienfuegos is scheduled to be completed next year. If completed as planned, these improvements could double Cuba's oil refining capacity by the 1990s, significantly reducing its dependence on Moscow for refined petroleum products. [redacted]

Other Soviet aid in the field of energy and transport includes technical assistance for the construction of what will be Cuba's largest thermoelectric plant, located east of Havana. The Soviets are also helping Cuba build a network of oil pipelines linking the new Cienfuegos refinery, the new supertanker port, the thermoelectric plant, and Havana. Deep oil wells are being drilled in northwestern Cuba and new port facilities to alleviate perennial congestion and distribution delays are being built with Soviet help. According to Cuban press reports, the Matanzas supertanker port will cost about \$200 million, and its four wharves will be able to accommodate Soviet ships of 70,000 to 150,000 tons. In addition, the USSR is constructing a new container terminal in Havana port. [redacted]

During the past two years, the Soviets have shown increasing irritation with Cuba's waste and mismanagement of economic resources. [redacted]

- Our natural disaster scenario takes the same assumptions as the baseline case but postulates that Cuba will be hit by another natural disaster about halfway through the five-year period.
- Our additional credit scenario assumes that Western creditors will finance all of Cuba's hard currency current account deficits, while Soviet aid levels do not rise and some small productivity gains are realized. [redacted]

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Our findings indicate that, even in the best circumstances, Havana will face serious problems in hard currency earnings that will, in turn, increase its debt problems with the West, complicate its export commitments to CEMA, and frustrate its objective of an improved standard of living. [redacted]

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All three scenarios contain the basic assumption that Cuba is unlikely to gain much additional relief from its Soviet patrons over the next few years. [redacted]

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[redacted] The Soviet-Cuban five-year trade and aid agreement signed in April 1986 apparently provides little additional relief to Havana. The Western press reports that the agreement fixes oil and sugar trade at 1985 levels. According to the Cuban press, Moscow agreed to a 50-percent increase in development credits for the current five-year plan. However, in the past, these credits have accounted for only about 10 percent of Soviet economic assistance to Cuba and are intended for large industrial development projects such as the nuclear power plant and oil refinery under construction near Cienfuegos. Although this increase in development aid may help Cuba's long-term economic potential, it will probably have little immediate impact on Havana's pressing economic problems. [redacted]

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Similarly, in all three cases, we assume Havana will have increasing difficulty motivating the labor force because the five-year plan's commitment to free market experiments will be observed in the breach. This is despite Havana's growing concern about labor discipline, as evidenced by recent speeches on the subject by Castro and other high officials. [redacted]

[redacted] apathy permeates the labor force, and workers have engaged in occasional acts of sabotage or strikes to vent their frustration. Worker morale is not likely to improve because the government apparently intends to use greater regimentation—rather than incentives—in the workplace, [redacted]

[redacted] We believe this approach will only exacerbate the problem. Moreover, workers will bear much of the burden of economic austerity as exports are given a higher priority than consumer goods or social services. Castro's reluctance to reward hard work through material gain, such as higher wages or bonuses, gives workers little reason to perform more efficiently. [redacted]

Baseline Scenario: Present Trends Continue

We estimate that Cuba's economy will grow by an annual average of about 2.2 percent⁵ during the next five years under the baseline scenario, in contrast to Havana's official target of 4 to 4.5 percent. This calculation is based on several assumptions; most important are that oil and sugar prices will remain roughly at current levels and that the USSR will not significantly increase its hard currency support or oil deliveries to Cuba. We also assume that Western creditors will reschedule existing debt and make available only \$1 billion in new credits over the five-year period, requiring Cuba to make fairly sizable cuts in imports to cover the difference (see table 2). [redacted]

Drop in Hard Currency Earnings. Implicit in these baseline assumptions is the fact that Cuban hard currency earnings are almost certain to drop over the next few years. We estimate, for example, that hard currency earnings from the reexport of Soviet-supplied oil—which has surpassed even sugar as

⁵ All model estimates for economic growth are real GNP per capita. [redacted]

Havana's largest foreign exchange earner over the past few years—will tumble, at least over the near term. Cuban Vice President Rodriguez indicated at a press conference in March that Cuba's oil earnings could fall from some \$575 million last year to \$375 million in 1986 (see appendix A). Despite tough energy conservation measures, Cuba's domestic oil consumption is not likely to fall much further as new energy-intensive plants are completed over the next five years. The outlook for domestic energy production is equally dismal; [redacted]

Furthermore, we believe prospects are dim that Havana will be able to fill the gap created by its loss of oil revenues. Hard currency earnings from its other traditional exports are likely to remain at present levels. Assuming a moderate increase in world sugar prices—which some industry experts believe is possible—sugar earnings may rise somewhat, but a substantial increase in earnings is unlikely. Looking at Cuba's track record, its goal of a 20-percent increase in crude sugar production over the next five years probably cannot be met, given its refinery capacity, inefficient production techniques, and the normal vagaries of its climate. Moreover, Cuba's heavy export commitments to CEMA also work against a substantial increase in earnings. We expect only modest increases, at best, in hard currency earnings from other leading Cuban exports such as fishing, tobacco, nickel, and citrus, which together account for about 16 percent of Cuban exports. [redacted]

With no increase in Soviet hard currency assistance and little potential growth in alternative export earnings, Havana will do well, in our view, to come even close to the \$7.5 billion in hard currency it earned during 1981-85. Indeed, we estimate that, under this baseline case, hard currency income will only total about \$4.6 billion during 1986-90, or a drop of some 40 percent, far short of the hard currency export goals of \$12.5 billion for the next five years. [redacted]

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Table 2
Baseline Economic Performance Projections, 1986-90

	1986	1987	1988	1989	1990
Key assumptions					
Soviet economic assistance (<i>million US \$</i>)	4,500	4,500	4,500	4,500	4,500
Sugar production (<i>thousand metric tons</i>)	7,668	7,737	7,722	7,709	7,723
Hard currency export earnings (<i>million US \$</i>)	955	971	896	826	827
Labor productivity (<i>percent change</i>)	-0.2	1.1	1.0	-0.5	-0.7
Key results					
GNP (<i>million US \$</i>)	16,796	17,720	18,539	18,978	19,257
GNP per capita (<i>percent change</i>)	2.7	3.9	3.0	1.0	0.3
Hard currency imports (<i>million US \$</i>)	960	859	777	714	713
Hard currency debt (<i>million US \$</i>)	3,388	3,606	3,824	4,042	4,260

Dealing With Creditors. If Cuba's economy generally tracks this baseline scenario path, the resulting hard currency crunch will most likely provoke growing strains with its Western creditors. As it is, difficulties are developing. In July, after months of hard bargaining, representatives of Cuba's leading official Western creditors—the Paris Club—agreed to debt rescheduling terms with Havana, but refused to provide new funds and demanded that it cut imports sharply this year and in 1987. Havana is still negotiating a rescheduling package with its private creditors, and we believe that the banks will call for equally tough austerity measures and distance themselves from many new loan commitments. In any case, any new loans will most likely carry higher interest rates to reflect increased risk. [redacted]

Creditors have repeatedly told Cuba that it will have to make up its financing gap through additional import cuts or assistance from the USSR. However, given Havana's traditional reluctance to cut Western imports and Moscow's apparent refusal to provide additional aid, Castro may be tempted to declare a debt moratorium or cancel Cuba's debts outright. Such a move would cost Havana access to all Western credit, but Castro may believe that the political advantages of such a bold move outweigh the economic losses—boosting his image in the Third World and striking a blow against Western interests. [redacted]

In our judgment, though, Castro will not take such a bold move. Cuba's economy will most likely suffer from additional shortages of Western imports—especially lower priority consumer goods—as Havana must now devote a larger share of its diminished hard currency export income to debt repayment. Havana is obligated to repay at least \$1.9 billion to Western creditors during 1986-90, according to Cuban statistics (see figure 2). Even if Havana manages to reschedule all of its principal payments of at least \$1.4 billion, which is unlikely, it would have to continue to pay interest totaling at least \$450 million. Assuming Havana reschedules this principal and receives \$1 billion in new credits over the five-year period, we estimate that interest payments will amount to more than \$1.5 billion, or one-third of Cuba's projected hard currency earnings during 1986-90. [redacted]

As a result of this potentially huge debt burden, we believe that Cuba's average annual economic growth will be a modest 2.2 percent through 1990. Production in many sectors of the economy will be hampered by shortfalls of key Western imports such as machinery, spare parts, and agricultural chemicals. The slower rate of growth, in turn, will probably exacerbate

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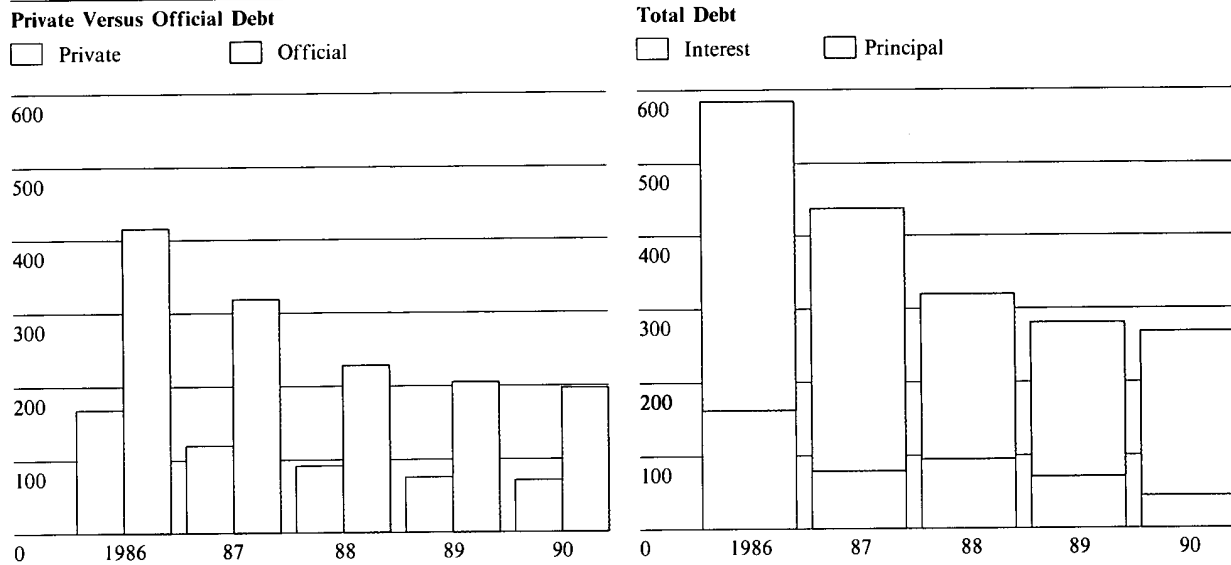
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Figure 2
Cuba: Debt Service Forecast, 1986-90^a

Million US \$



^a Excludes changes resulting from rescheduling of some of the private and official debt principal that fell due in 1985. As a result of last year's rescheduling exercise, these principal repayments will not begin to fall due until 1990. Total debt repayments over the period will thus be higher as Havana pays interest charges on the rescheduled 1985 debt, on debt incurred beginning in 1985, and on debt rescheduled between 1986-90.
Source: National Bank of Cuba.

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unemployment, contribute to rising discontent, and lead to increased repression as the regime tries to deal with its economic problems through increased discipline in lieu of economic reform.

Natural Disaster Scenario

Beyond these more predictable circumstances, Cuban planners apparently have not taken into account other factors, such as natural disasters that have traditionally wreaked havoc on the island's agricultural production. Castro has stated that last year's hurricane resulted in \$1 billion in damage to crops and infrastructure, such as ports and roads. In 1979 and 1980, an outbreak of African swine flu dealt a severe blow to Cuba's pork production. In another example, blue mold disease destroyed almost the entire tobacco crop in 1980.

The impact of cyclical problems in agricultural production—when Cuba is struggling to satisfy CEMA quotas and expand exports to the West—could temporarily weaken its already vulnerable economy. For example, we calculate that, if a natural disaster reduced sugar and nonsugar agricultural output by 25 percent each in 1988 and cut the nation's capital stock by 10 percent, then overall economic growth would fall by 4 percent and hard currency export earnings would decline by 20 percent in 1988, as compared to the baseline scenario. National output would recover to baseline levels by 1990, however.

Additional Western Credit Scenario

Even under a fairly upbeat scenario, Cuban economic growth is likely to fall below the targets set. If, for

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Performance and Prospects in Key Industries

The traditional sectors of the Cuban economy—sugar, nickel, tobacco, and fishing—have generally performed poorly in recent years, while efforts at diversification have proved disappointing. Despite Castro's call for a broader Cuban role within CEMA, especially in the electronics field, Moscow has shown little inclination to permit Havana to alter significantly its primary position as supplier of food and raw materials to the USSR and Eastern Europe. At the same time, Havana is unlikely to attract Western investment that could aid in developing new products.

The performance of the sugar industry, the most important sector of the Cuban economy, was probably the worst of any of the country's major industries during the last five-year plan. Hard currency revenues from sugar sales have declined by 80 percent since 1981 largely because of the precipitous fall in world sugar prices. In addition, production shortfalls caused by inefficient harvesting as well as drought and hurricane damage, combined with Moscow's pressure on Havana to fulfill its CEMA quotas, have forced Havana to purchase large amounts of sugar on the world market during the past two years. As a result, Cuba's net hard currency sugar income actually totaled about \$250 million in 1984 and 1985. Although sugar prices have picked up some since last summer, the increase probably will not be enough to boost earnings significantly (see appendix A).

The fishing industry is recovering from a downturn in the late 1970s and early 1980s. Although the fish catch has increased about one-fifth since 1981, hard currency export earnings declined by about 15 percent between 1981 and 1984 to \$104 million, according to Cuban statistics. Moreover, the fish catch is unlikely

to increase much more, in our opinion, limiting the potential for an increase in Cuba's export earnings. Havana has dramatically reduced its tuna fishing fleet to save fuel, and we expect fuel shortages and the lack of new fishing areas to continue to restrict growth in this sector.

Cuban tobacco production also seems unlikely to expand much beyond its current output of 40,000 to 50,000 tons per year. One reason for the lack of development in the tobacco industry, is that the same factories and technology used to produce cigars and cigarettes in 1959 are still being used. Consequently, annual hard currency export income probably will not rise significantly above current levels.

The Castro regime has been making a major effort to expand its nickel output. Cuba now has three operational nickel-processing plants and one under construction. Although the expanded facilities could almost double nickel production to 60,000 tons per year, Cuba will not gain much in hard currency earnings—now about \$40 million annually—because most of the increased production is earmarked for Moscow. Moreover, Cuba's earnings from nickel will continue to be limited by US agreements with several West European countries and Japan that prohibit use of Cuban nickel in their steel exports to the United States.

Havana is making a major effort to develop its tourism industry, but the lack of access to the US market and the absence of any significant Western investment will probably keep annual hard currency earnings below \$150 million. We estimate, that Havana has lost

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at least \$40 million in hard currency income because of the ban against travel by US citizens. [redacted]

The slump in hard currency income from traditional sectors is unlikely to be made up by new industries. Cuba invested considerable resources toward import-reducing industries as well as alternative exports, such as domestic oil production and citrus fruit. Although Havana managed to more than triple its oil production between 1981 and 1985, domestic output accounts for only about 10 percent of Cuba's petroleum needs. Havana wants to more than double its domestic oil output by 1990, in the hope of reducing its dependence on Soviet oil and boosting hard currency earnings. Even if Havana managed to achieve this ambitious goal—which we believe is unlikely—a continued weak oil market and the leveling off of oil conservation as new nickel and thermoelectric plants open will offset much of the rise in production. Citrus production, which grew rapidly from the late 1970s until 1983, probably will increase at a slower pace through 1990. Because some 90 to 95 percent of Cuba's citrus crop is committed to CEMA, this industry is unlikely to yield significant hard currency dividends for Havana. [redacted]

Havana's prospects in nontraditional areas are also bleak. In recent years, Cuba has invested in alternative industries such as electronics technologies—including computers and semiconductors—but is probably too far behind to compete in world export markets for these products. Moreover, Cuba's hard currency exports will continue to be curtailed by limited access to Western technology, machinery, and spare parts as well as by chronic low labor productivity, mismanagement, and corruption. [redacted]

example, we assume that Havana's Western creditors will finance all of its projected hard currency current account deficits, then Cuba could avoid further cuts in producer imports and would be able to import 25 percent more from the West, in comparison with the baseline case, through 1990. In particular, Havana could maintain its imports of Western consumer and intermediate goods—such as raw materials and spare parts—over the period compared with the baseline situation, where these imports were cut by about one-third and one-fourth, respectively. Even assuming generous Western financing, average annual economic growth would be more than 3 percent, which, while significantly higher than our baseline estimate of 2.2 percent, still falls far short of Havana's target of 4 to 4.5 percent. Moreover, hard currency earnings will remain at about the same low level as in the baseline scenario, as Havana is battered by weak sugar and oil revenues and fails to diversify its exports. Moreover, the leveling off of Moscow's economic assistance will constrain the economy just as in the baseline situation. [redacted]

Implications for the United States

Cuba's continuing economic problems will probably reinforce current trends in its relations with the West and with the United States in particular. However, while we do not expect dramatic changes in Cuban attitudes, economic conditions—perhaps added to other, unforeseen pressures—might cause Havana to alter certain policies, such as repayment of debt, international travel, or trade. On the financial front, for example, faced with such a large debt burden, Castro may give some consideration to canceling his debt with the West, particularly in view of his intensive campaign last year calling on other Latin American nations to renege on their debts. Castro may have

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From Bad to Worse: Castro's Nightmare Scenarios

In our discussion of the three most likely scenarios, we assumed that Soviet aid during 1986-90 would remain at 1985 levels and that Western creditors would supply Havana with at least \$1 billion in new hard currency credits over that period. The econometric model of Cuban national output demonstrated that, even with moderate Western financing, Cuban economic growth probably would lag far behind Havana's official target of 4 to 4.5 percent a year.

We have used the model to test the outcome of two "worse case" scenarios for Cuba: a total cutoff from Western credit and a sharp drop in Soviet funding.

Westerners Freeze Credit Scenario

Cuba's relations with its official and commercial creditors became increasingly strained in 1986 as its spendthrift policies violated Paris Club financial targets and its foreign exchange shortages led to the suspension of interest and principal payments. By September, Havana had failed to extract any commitment of new funding from the Paris Club, and projected commercial lending fell far short of Cuban requests. Continuing hard currency shortages and an impending payments crunch in November suggest that creditor relations may deteriorate further.

To measure the impact of a withdrawal of Western credit, we assumed that no new hard currency credits would be available to Cuba in 1987-90, so that Havana would have to fund all Western purchases

with reserves and export income. According to the model, the suspension of new credits would require a 20-percent cut in hard currency imports over the five-year planning period as compared to the baseline scenario. The sharp drop in imported capital goods would have a severe impact on the economy over time. Average annual economic growth over the period would slip from 2.2 percent in the baseline case to 1.9 percent under this scenario. More significantly, the cumulative effect of sharp import cuts on Cuba's decaying capital stock would contribute to economic stagnation by 1989-90. Over the short term, the most noticeable impact of sharp import cuts would be declining personal consumption and stepped-up conservation efforts by Havana that would most likely fan discontent among a population already weary of sacrifice.

The Soviets Pull the Plug Scenario

Although Moscow has pledged to maintain economic assistance to Cuba during the rest of the decade at 1985 levels, we believe there is a chance—albeit slight—that the Soviets suddenly could slash their aid. According to the US Interests Section, Moscow has expressed increasing displeasure with recent Cuban economic policies, such as the elimination of farmers' free markets and other market incentives. Further movement by Havana away from the Soviet economic model, combined with probable Cuban trade shortfalls and Soviet economic difficulties, could spur Moscow to reduce temporarily economic aid in an attempt to force reform on the chronically mismanaged Cuban economy.

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viewed this campaign as a way of gaining leverage with his own creditors. On balance, however, we believe there is only a slim chance that Castro will cancel Cuba's debt, since such a radical move would cost the country virtually all future access to Western credit.

With little hope for significant economic improvement over the next few years, the Castro regime will be hard pressed to provide an outlet for increasing

popular discontent. In our opinion, pressure will build on Castro to permit another mass emigration similar to the Mariel exodus of 1980 and the Miami-Varadero airlift of 1965-72. If this occurs, Castro will again probably attempt to embarrass Washington by sending the unskilled and social outcasts to the United States.

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We examined the effects of a cut in Soviet aid by making the following assumptions on the baseline model:

- A decline in the quantity of oil financed by Moscow from 240,000 barrels per day (b/d) in our baseline model to 205,000 b/d in 1986 and 170,000 b/d a year in 1987-90.
- A reduction in the average annual domestic energy consumption from 335,000 b/d in our baseline model to 295,000 b/d to compensate for reduced supply.
- The gradual elimination by 1990 of the Soviet subsidy on sugar. [redacted]

The scenario of plummeting Soviet assistance is by far the most damaging to the Cuban economy, effectively setting it back 10 years and severely weakening the industrial base—the foundation for longer term economic growth. Assuming only a moderate increase in Western funding, the loss of petroleum and sugar earnings would force a comparable cut in imports so that hard currency trade would drop by 33 percent to the levels of the mid-1970s. Reduced capital goods imports would contribute to a 5-percent decline in industrial output. Average annual economic growth would fall from 2.2 percent in our baseline scenario to just 1.4 percent over the five-year period. Furthermore, economic growth would contract by 1990 to -0.5 percent. [redacted]

Rising unemployment and the need to boost hard currency earnings will most likely encourage Havana to attempt to expand its civilian assistance projects abroad. Havana may hope that sending workers abroad—especially younger and better educated technicians, doctors, and engineers who often have difficulty finding suitable employment in Cuba—will help stem discontent at home. An expansion of these programs may also help to improve Havana's prestige and "internationalist" image in the Third World. To

accomplish this, Havana probably would concentrate its efforts on the Middle East and North Africa—areas where it receives hard currency in return for its services. [redacted]

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[redacted] Havana may have difficulty increasing its foreign projects abroad, however, as the oil crisis forces many countries to curtail their budgets. [redacted]

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Havana may relax its ban on Cuban-American travel—imposed by Castro after Radio Marti began broadcasting in May 1985—as pressure builds to increase tourism earnings. Nonetheless, Castro is undoubtedly aware that similar visits in 1979 helped touch off the Mariel exodus in 1980, and will probably weigh any economic considerations against the possibility of ideological contamination. In addition, Havana may intensify its efforts to obtain hard currency through a continuing scam in which the Cuban Government permits emigration in return for a substantial payment by foreign relatives. [redacted]

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We believe Havana also will intensify its efforts to evade the US trade embargo as part of its drive to increase hard currency exports and to acquire advanced technology—such as computers and other electronic equipment—using its network of front companies. We estimate that there are at least 100, and possibly as many as 130, of these front companies worldwide. [redacted]

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[redacted] that could give Havana increased access to US-origin technologies. We doubt, however, that Cuba will earn much additional revenue through embargo evasion because of the limited nature and poor quality of its exports. [redacted]

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Havana would clearly benefit from a resumption of economic ties to the United States, but we doubt that Castro would be willing to make the necessary political concessions. In his foreign policy, Castro has steadfastly upheld his commitment to promote violent

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Popular Dissatisfaction With the Economy

There is growing evidence of increasing popular discontent in Cuba. A recent survey by the US Interests Section in Havana revealed widespread discontent with serious shortages of a wide array of food products and poor housing and transportation services. Surveys published in the Cuban press last year reflected an astonishing rise in absenteeism and other labor problems, indicating that Havana is having considerable difficulties motivating its work force.

[redacted] the regime's own media, revealed a rapid rise in the official unemployment rate last year to about 5 percent, in addition to an increase in suicide and crime rates. [redacted]

We believe the deteriorating Cuban economy is the primary factor underlying discontent in Cuba and that popular dissatisfaction will grow as it becomes clear to a new generation of Cubans with higher expectations that there is little prospect for immediate improvement in their standard of living. Spending cuts on housing, education, and other social programs, which we view as inevitable under the present economic plan, will provide rich breeding grounds for popular disgruntlement. Moreover, collective apathy will further depress the already low levels of productivity and add to Havana's difficulties in meeting its overambitious economic, political, and social goals over the 1986-90 period. [redacted]

We believe the regime's strong internal security forces and the lack of any organized opposition group around which Cuba's disillusioned can gather will make organized protests, major strikes, or demonstrations unlikely. Growing levels of discontent, however, could lead to isolated confrontations with government security forces. [redacted]

[redacted]

Table 3 Percent
Cuban Per Capita Economic Growth
Under Five Scenarios

Scenarios	Real GNP Growth					Average Annual Growth 1986-90
	1986	1987	1988	1989	1990	
Baseline scenario	2.7	3.9	3.0	1.0	0.3	2.2
Alternative scenarios						
Natural disaster	2.7	3.9	-0.9	3.3	2.2	2.2
Additional Western credit	3.4	4.3	3.3	2.9	2.8	3.3
Westerners freeze credit	2.7	3.1	3.0	0.7	0.0	1.9
Soviets pull the plug	1.6	3.4	2.5	0.1	-0.5	1.4

[redacted] revolution abroad as one of the fundamental pillars of his revolution. Moreover, he cannot afford to alter his relationship with Moscow, given his almost complete dependence on the Soviets for economic and military security. Only if Moscow significantly reduced its aid to Havana—which is very unlikely—would Castro probably consider seriously negotiating any key differences with Washington. [redacted]

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Appendix A

Statistical Review

Table A-1
Cuba: Hard Currency Debt
as of 31 December 1985

Million US \$

Total debt disbursed	3,552
Official bilateral debt	1,823
Intergovernment loans	157
Development aid	34
Government-guaranteed export aid	1,632
Official multilateral debt	20
Suppliers	399
Financial institutions	1,310
Bank deposits and loans	1,209
Medium-term bilateral and consortium loans	484
Short-term deposits	725
Current import credits	101
Other credits	NEGL

Source: National Bank of Cuba

Table A-3
Estimated Soviet Economic Assistance to Cuba, 1981-84

Million US \$

	1981	1982	1983	1984
Total	4,558	4,666	4,260	4,620
Economic aid ^a	1,415	975	1,070	1,000
Trade	912	481	500	460
Development aid	453	444	520	490
Technical services	50	50	50	50
Trade subsidies ^b	3,143	3,691	3,190	3,620
Sugar	1,366	2,580	2,740	3,420
Petroleum	1,657	1,006	345	100
Nickel	120	105	105	100

^a On the basis of estimated balance-of-payments aid necessary to cover Cuban soft currency trade deficits with the USSR, Cuban purchases of capital goods from Moscow, and public statements by Cuban and Soviet officials concerning the amount of development aid extended.

^b Based on Cuban and Soviet trade data.

Table A-2
Cuba: Sugar Production and Prices, 1981-85

	1981	1982	1983	1984	1985
Production ^a (thousand metric tons)	7,359	8,207	7,460	7,783	7,889
Prices ^b (cents per pound)	16.9	8.5	8.5	5.2	4.1

^a Calendar year.

^b Average annual export price, f.o.b. Caribbean ports; actual price received by Cuba may differ because of seasonality of deliveries.

Source: CIA *Handbook of Economic Statistics, 1986*

Table A-4 ^a
Cuban Hard Currency Earnings, 1981-85

Million US \$

	1981	1982	1983	1984	1985 ^b
Total	1,799	1,627	1,431	1,283	1,356
Sugar	1,068	793	368	258	187
Nonsugar	522	618	485	477	595
Tobacco	69	142	86	58	NA
Fish	126	118	109	104	NA
Nickel	75	80	41	40	NA
Naphtha	20	78	81	NA	NA
Coffee	36	36	46	19	NA
Other	196	164	122	256	NA
Reexports ^c	209	216	578	548	574

^a The data in this table are official Cuban statistics released to creditors. The US dollar amounts were calculated using average annual official Cuban exchange rates.

^b Estimated.

^c Reexports represent oil that Cuba was successful in saving and reselling for hard currency.

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Table A-5
Cuba: Subsidized Versus World Market
Prices for Cuban Sugar Exports and
Petroleum Imports, 1981-84

	1981	1982	1983	1984
Petroleum (US dollars per barrel)				
World	34.5	33.6	29.3	28.7
USSR	14.0	20.5	27.2	27.9
Subsidy	20.5	13.1	2.1	0.8
Sugar (cents per pound)				
World	16.9	8.5	8.5	5.2
USSR	35.2	35.8	49.5	55.2
Subsidy	18.3	27.3	41.0	50.0

Sources: Cuban and Soviet trade data; various issues of *IMF International Financial Statistics*

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Table A-6
Cuba: Hard Currency Current Account Balance, 1981-85

Million US \$

	1981	1982	1983	1984	1985 ^a
Trade balance	364	727	511	82	73
Exports	1,799	1,627	1,431	1,283	1,356
Socialist ^b	422	747	600	598	NA
Imports	1,435	900	920	1,201	1,283
Net services and transfers ^c	-300	-368	-273	-321	-226
Current account balance	64	359	238	-239	-152

^a Preliminary.

^b Hard currency purchases of Cuban goods by socialist countries.

^c Includes primarily tourism, ship chartering, construction, and transportation.

Sources: Various issues of *Anuario Estadístico de Cuba*; various National Bank of Cuba publications

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Appendix B

The Cuban Economic Analysis and Forecasting System (CEAFS)

CEAFS is an economic model of Cuba [redacted] that is used to derive projections for 1986 through 1990. The model combines a theoretical representation of the Cuban economy, a statistical analysis of the key relationships, and assumptions about government policies and external events in a system of equations. Solving the model produces conditional estimates of the future; comparisons of separate outcomes under different assumptions can be made to determine the sensitivity of the economy to alternative future conditions. As with all models in the social sciences, however, the predictive capacity of CEAFS—its ability to answer the “what if?” questions—is limited by the accuracy of the assumptions made by the analyst.

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Although econometric models have become conventional tools for analyzing market economies, the Cuban model differs from standard models because of Cuba’s status as a less developed country, and, in particular, as a centrally planned economy. Unlike standard econometric models, which are dependent on a large body of accurate data, the Cuban model must accommodate inadequate statistics. Adequate data are generally lacking because of Cuba’s poorly developed markets, the exclusion of certain economic sectors from official measures of economic performance, the failure of prices to reflect market forces, and the falsification of data for political purposes. In many cases, CEAFS uses proxy data to substitute missing or unreliable Cuban statistics. In addition, CEAFS assumes theoretical economic relationships that are usually tested in a standard model. Moreover, a nonstandard model is more appropriate for estimating Cuban economic performance because the radical changes in policy and weather that often occur in Cuba would invalidate a standard model’s system of equations.

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