
Cuba

1. General trends

After growing by 1.5% in 2002, Cuba's gross domestic product posted an increase of 2.6% in 2003, fuelled by expansions in international tourism, family remittances and merchandise exports; the repair of damage caused by the three hurricanes that struck the island in the previous biennium; and an upturn in non-sugar agriculture, although the agricultural sector as a whole has been hurt by a drought. In particular, the sugar sector, beset by financial constraints and organizational problems, saw a sharp contraction in output.

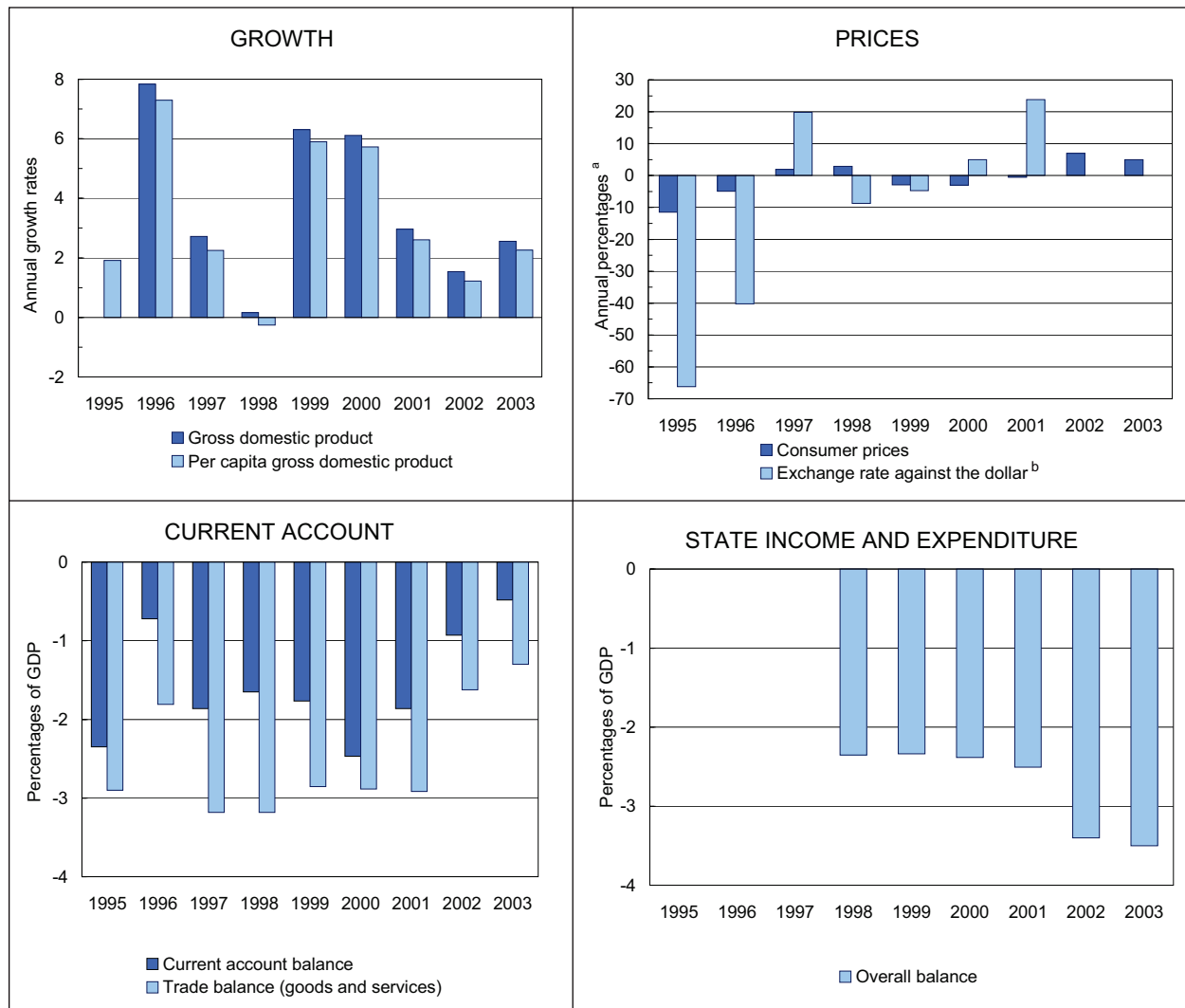
GDP growth was close to 4.5% in the first half of 2004, but this rate is expected to slow down in the second half of the year, for an overall 2004 growth rate of about 3%, amid fears of overheating in the external sector. At the sectoral level, the sugar industry rallied, producing 2.5 million tons and expanding by 15%, after the collapse in output observed in the preceding harvest. The flow of tourists rose by more than 10%, thus increasing the likelihood that the target level of 2 million visitors will be met this year, after having been pushed back by the terrorist attacks of September 2001. By the end of 2004 the fastest-growing sectors are likely to be international tourism (10%) and mining, owing to an increase in oil and gas extraction (7.5%, for a total of 4.6 million tons oil equivalent) and nickel extraction (7%). Non-sugar agricultural production is projected to grow by 3.7% and non-sugar industrial production, by 2.5%. Electricity generation is expected to expand by 1.6% thanks to full utilization of domestically produced crude oil and gas.

Since the demise of the Council for Mutual Economic Assistance (COMECON) more than a decade ago, the Cuban economy has been in a process of structural reform. The loss of the privileged position it enjoyed under that system generated serious macroeconomic imbalances that forced the country to

undertake a far-reaching economic restructuring based on a new foundation of openness to foreign direct investment, development of the tourism sector, expansion of mining activities (nickel and oil) and strengthening of goods and services exports in the areas of biotechnology and pharmaceuticals. In contrast, the restructuring of traditional activities such as the sugar industry has made little headway thus far, and the use of available resources is still very inefficient. Meanwhile, the protracted embargo imposed by the United States continues to hobble the country's development and will become even more onerous when new restrictions enter into force in the second half of 2004. The embargo's impact has been softened by voluminous inflows of family remittances, mostly from the United States, but there is no guarantee that these flows will not ebb in future years.

In the last fiscal year the Cuban economy continued to be plagued by structural problems such as the shortage of foreign exchange, which leaves economic policy little room for manoeuvre; the two-tier monetary and pricing system; the overvaluation of the official exchange rate and the lack of convertibility of the local currency; the weak performance of the sugar industry; the inefficiency of public entities owing to the slowness of efforts to improve business practices; the economy's dependence

Figure 1
CUBA: MAIN ECONOMIC INDICATORS



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

^a December-December variation.

^b Unofficial rate.

on low-value-added exports; the large share of oil and food in the overall import bill, which makes imports of capital goods for modernizing production less affordable; the high import share of tourism services; and the decline in the purchasing power of wages in the

face of high free-market prices. It should be borne in mind that wages are related to the official exchange rate (one peso to the dollar), whereas prices on unregulated markets are linked to the commercial exchange rate (26 pesos to the dollar).

2. Economic policy

It is estimated that in 2004 the fiscal gap will widen slightly (to 3.5% of GDP), but currency in circulation (M1) will decline, primarily because of an increase in retail sales (5.5%). Prices will probably become more unstable in response to the United States government's imposition, in May 2004, of new restrictions on travel to the island by United States citizens and on remittances by United States residents to relatives in Cuba. In addition, the Cuban government raised prices (by an average of 15.4%) on fuel and on goods priced in foreign exchange, and this move is also likely to generate inflationary pressures.

(a) Fiscal policy

At 9%, the growth of current income outpaced that of capital income (8.8%). Among current inflows, tax and non-tax revenues grew at virtually the same rate (9%). Among tax revenues, indirect taxes grew the fastest (by 10.1%), although direct taxes also rose (by 7.5%). This reflected higher receipts from circulation and sales taxes (9.2%) and from service taxes (19.6%). In the case of direct taxes, the biggest increases were in receipts from profit taxes (9.1%), personal income taxes (7.4%) and social security contributions (5.1%), while those from the tax on the utilization of the labour force rose moderately (2.9%).

On the expenditure side, current expenditure increased the fastest in the areas of science and technology (28.9%), culture and art (21.3%), sports (19.5%), education (16.6%) and health (5.6%). Subsidies for losses incurred by State-owned enterprises (2.9% of GDP) continue to weigh heavily on the budget, having shot up by 41.6% in 2003 and 119% in 2002. These subsidies are concentrated in the agricultural sector, which in the past two years has been crippled by three hurricanes and a drought.

The amount of budgetary resources allocated to capital formation was down (-2.3%), but priority was given to the construction of housing for the victims of hurricanes Isidore and Lili and to the tourism development programme. Large slices of investment were also earmarked for the strengthening of social policy, the sugar industry, forestry development, the development of pastureland and shade tobacco, soil improvement and waterworks.

In 2004 current income is again expected to increase more than capital income (with upturns of 12.8% and

0.2%, respectively). Among current revenues, non-tax receipts (13.1%) will probably outpace tax receipts (12.8%). Among tax revenues, indirect taxes (18.5%) should grow faster than direct taxes (4.3%). According to projections, circulation and sales tax receipts will go up by 19.8% and service tax receipts, by 6.7%. Social security revenues are also expected to increase (6.8%) as more workers take part in the programme to improve business practices and the tax rate rises (to 12.6%, from 12% up until 2003). Profit tax receipts should rise by about 6% owing to the expansion of the production sector.

On the expenditure side, capital expenditure (26%) is projected to rise more sharply than current expenditure (11.2%). Current outlays will include disbursements for social well-being and assistance (26.1%), education (19.2%), culture and art (15%) and health (11.8%) under the initiative to strengthen social programmes.

(b) Monetary policy

Liquid assets held by the population (M2) diminished to 47.5% of GDP, compared to 47.9% in 2002. This was the result of an increase in fixed-term deposits (42.8%) triggered by an upturn in 3-, 6- and 12-month interest rates, and a 1.1% decline in the monetary aggregate M1. Within M1 there was a decline in currency in circulation (-4.2%) and an increase in regular savings account deposits (2.5%).

The State received higher monetary income through retail sales (14%), electricity services (4.5%) and charges for housing, electricity, gas and water (8.5%). It increased its outlays on wages, salaries and payments to basic units of cooperative production (5.2%) and on social security (11%).

The commercial exchange rate held steady at 26 pesos to the dollar. At the same time, the official exchange rate was maintained at one peso to the dollar.

The relative price system continued to show distortions due to the overvalued official exchange rate, deflationary biases, the significant weight of non-commercial services, the two-tier monetary and exchange-rate system and market segmentation. The overvaluation of the official exchange rate discourages exports and hurts labour productivity, while the local currency's lack of real convertibility makes the competitiveness of Cuba's goods and services exports impossible to measure with any precision.

Table 1
CUBA: MAIN ECONOMIC INDICATORS

	1995	1996	1997	1998	1999	2000	2001	2002	2003 ^a
Annual growth rates^b									
Gross domestic product	...	...	2.7	0.2	6.3	6.1	3.0	1.5	2.6
Per capita gross domestic product	...	60.5	2.3	-0.3	5.9	5.7	2.6	1.2	2.3
Gross domestic product, by sector	...								
Agriculture, livestock, hunting, forestry and fishing	...	...	2.3	-14.1	11.6	9.1	0.9	-2.5	2.6
Mining	...	...	2.8	-11.7	2.7	33.2	-3.6	12.6	3.0
Manufacturing	...	...	6.2	-8.1	7.2	5.1	-0.6	0.1	-2.4
Electricity, gas and water	...	...	7.0	3.7	8.1	12.8	1.1	2.4	3.4
Construction	...	...	3.0	-2.6	7.5	8.4	-5.3	-2.4	1.1
Wholesale and retail commerce, restaurants and hotels	...	...	-0.2	5.8	0.7	7.6	4.4	2.0	4.8
Transport, storage and communications	...	...	3.1	15.6	17.6	5.0	8.4	0.0	-0.2
Financial institutions, insurance, real estate and business services	...	...	1.7	5.1	12.7	0.9	5.4	1.2	4.0
Community, social and personal services	...	...	3.6	0.2	4.7	3.5	5.5	4.8	...
Gross domestic product, by type of expenditure	...	...	2.3	1.5	5.1	2.3	3.4	3.0	...
Consumption	...	...	2.3	1.5	5.1	2.3	3.4	3.0	...
General government	...	...	2.3	0.1	5.2	2.9	2.2	5.8	...
Private	...	...	2.3	1.9	5.1	2.1	3.8	2.1	...
Gross fixed capital formation	...	...	5.7	4.2	5.7	9.6	-2.8	-8.9	...
Exports (goods and services)	...	...	-4.9	5.8	12.8	14.1	-3.6	-3.8	...
Imports (goods and services)	...	...	-1.9	1.4	2.4	-0.2	-3.8	-7.3	...
Percentages of GDP									
Investment and saving^c									
Gross domestic investment	17.0	17.2	16.2	14.3	12.9	13.5	11.4	10.9	11.7
National saving	14.6	16.5	14.3	12.6	11.1	11.1	9.6	9.9	11.2
External saving	2.3	0.7	1.9	1.7	1.8	2.5	1.9	0.9	0.5
Millions of dollars									
Balance of payments									
Current account balance	-518	-167	-437	-392	-462	-696	-547	-296	-155
Merchandise trade balance	-1 484	-1 790	-2 265	-2 689	-2 909	-3 120	-3 171	-2 727	-2 970
Exports, f.o.b.	1 507	1 866	1 823	1 540	1 456	1 675	1 622	1 402	1 655
Imports, f.o.b.	2 992	3 657	4 088	4 229	4 365	4 796	4 793	4 129	4 625
Services trade balance	845	1 372	1 519	1 932	2 163	2 306	2 313	2 211	2 550
Income balance	-525	-493	-483	-449	-514	-622	-502	-600	-650
Net current transfers	646	744	792	813	799	740	813	820	915
Capital and financial balance ^d	596	174	457	409	485	805	595	300	200
Net foreign direct investment	5	82	442	207	178	448	39	0	0
Financial capital ^e	0	0	0	0	0	0	0	0	0
Overall balance	79	8	21	17	23	109	47	4	45
Other external-sector indicators									
Terms of trade (index: 1995=100)	100.0	108.7	104.9	100.9	92.4	79.9	82.7	82.8	88.1
Official exchange rate (pesos per dollar)	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Average unofficial exchange rate (pesos per dollar)	32.10	19.20	23.00	21.00	20.00	21.00	26.00	26.00	26.00
Total gross external debt (millions of dollars) ^f	10 504	10 465	10 146	11 209	11 078	10 961	10 893	10 900	11 000
Total gross external debt (% of GDP) ^f	48.3	45.3	43.3	47.1	42.4	38.9	37.0	34.3	34.0

Table 1 (concluded)

	1995	1996	1997	1998	1999	2000	2001	2002	2003 ^a
Average annual rates									
Employment									
Unemployment rate	7.9	7.6	7.0	6.6	6.0	5.5	4.1	3.3	2.3
Prices									
Variation in consumer prices (December-December)	-11.5	-4.9	1.9	2.9	-2.9	-3.0	-0.5	7.0	-1.0
Percentages of GDP									
State income and expenditure									
Current income	50.5	49.6	51.7	50.2	51.5	54.5
Current expenditure	48.3	45.8	49.1	46.9	49.7	52.0
Current balance	2.2	3.9	2.6	3.4	1.8	2.5
Net capital expenditure	4.6	6.2	5.0	5.9	5.1	4.7
Financial balance	-2.4	-2.3	-2.4	-2.5	-3.4	-3.5
Money									
Currency in circulation	18.0	22.1	23.8	...
M1	34.6	38.6	41.9	...
M2	37.2	42.0	45.4	...

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures, and ECLAC, *Cuba: Evolución económica durante 2000* (LC/MEX/L.525), Mexico City.

^a Preliminary figures. ^b Based on figures in local currency at constant 1997 prices. ^c Based on figures in local currency at current prices. ^d Includes errors and omissions. ^e Refers to the capital and financial balance (including errors and omissions), minus net foreign direct investment. ^f Calculated using the official exchange rate of 1 peso to the dollar.

With respect to monetary policy and economic regulation, in mid-2003 foreign exchange was concentrated in the hands of the central bank through the establishment of exchange controls and the wider circulation of the convertible Cuban peso (CUC) in the domestic economy. Thus, the CUC was established as the only means of payment in which dollar or other foreign-currency transactions between Cuban entities could be denominated and carried out.¹ Cuban entities were also required to convert all their foreign-currency-denominated assets, liabilities and capital accounts into CUC at the exchange rate of one CUC to the dollar. The assets and liabilities of entities that are wholly or partially foreign-owned are exempt from this rule and remain denominated in foreign currency.

(c) Other policies

The drive to improve business practices continued in 2003, extending to some 600 firms, which account for almost 20% of the total and contribute 38% of Cuba's business output and 40% of its profits. The country's

leading industries –petroleum, nickel and electricity– are participating in this scheme. The idea is to make more efficient use of financial, material and human resources, and particularly of foreign exchange, and to give the firms more autonomy in the management of part of their profits. The sugar industry was further restructured to cut production costs (in view of falling international prices), concentrate production in the most efficient refineries and croplands, shift resources towards import substitution and develop new sugar-cane derivatives.

Like other countries of the region, Cuba has witnessed a gradual downturn in foreign direct investment inflows as the divestiture of public entities, which began in the early 1990s, has drawn to a close and as its structural and institutional reforms have proved to be too limited. The number of joint ventures involving foreign capital declined to 342 economic partnerships in 2003, compared to 403 in 2002. By the end of 2003 Cuba had signed reciprocal investment promotion and protection agreements with 63 countries and double taxation treaties with 11 countries.

¹ The term "Cuban entities" refers to State-owned enterprises, trading companies that are wholly Cuban-owned, budgeted units and all other Cuban entities that operate in foreign currency, with the sole exception of joint ventures and international economic partnership contracts established under Law No. 77 on foreign investment.

3. The main variables

(a) Economic activity

Overall supply expanded by 3.2% thanks to an increase in imports of goods and services (7.2%), since output rose by 2.6%. Demand was up as well, fuelled mainly by external demand (7.9%) but also, to a lesser extent, by domestic demand (2.4%). Gross investment picked up (10%) and consumption expanded (1.3%), reflecting higher government spending (2.7%), since private spending rose only moderately (0.8%).

Investment activity gave priority to energy projects with rapid returns, the completion of approximately 2,000 rooms for international tourism, the modernization and rehabilitation of nickel plants, the electrification of agricultural irrigation systems (in order to save diesel fuel) and social programmes.

The best-performing sectors were international tourism (13%), commerce, restaurants and hotels (4.8%), government services (4.1%), financial services (4%) and electricity, gas and water (3.4%). Mining (3%), agriculture (2.6%) and construction (1.1%) recorded slower growth, while manufacturing slumped (-2.4%), dragged down mainly by the sugar subsector. The sugar crop was down by one third (2.2 million tons) owing to financial constraints that hampered the purchase of inputs for the harvest, organizational problems and bad weather conditions.

In the mining sector, domestic extraction of crude oil and gas was up by 4% (4.3 million tons oil equivalent), which enabled the country to reduce its oil bill (thereby saving some US\$ 53 million) and to improve the supply of domestically produced fuel and electricity to the population. Conversely, nickel production shrank (by 4.5%, to 71,700 tons), but the estimate for 2004 is 76,000 tons.

Gross electricity generation grew by 1.3% and 50,000 additional housing units were connected to the grid, with the result that 95% of Cuban households were supplied with electric power. In 2003 domestically produced crude oil and gas increased enough (by 4.5% and 11.7%, respectively) to meet 50% of the country's total energy needs and 90% of the electric power industry's needs.

(b) Prices, wages and employment

Inflation plummeted, turning negative in 2003 (-1%) after having climbed to 7% in 2002. The unemployment

rate declined from 3.3% to 2.3% thanks to the creation of 128,122 new jobs, 48% of them in the eastern provinces, while the employment rate (employed population as a percentage of the working-age population) rose to 69%.

The lack of correlation between wages and free-market prices continues to have negative effects, including distortions in the agricultural sector due to the income differential between subsectors with regulated prices and those with unregulated prices; supply shortages in non-agricultural free markets; problems in returning to a situation where employment is the main source of income, thus stimulating labour productivity; and difficulties in increasing household consumption.

In May 2004 the authorities raised consumer prices on articles sold in hard-currency shops. These increases amounted to about 10% in the case of food items, toiletries, cleaning products, children's footwear, cosmetics, home appliances, furniture and mattresses; between 12% and 20% for adults' clothing and footwear; and between 5% and 22% for sports equipment and fuel.

(c) The external sector

The balance-of-payments current account deficit fell from US\$ 296 million to US\$ 155 million, equivalent to 0.5% of GDP, as the net result of a US\$ 96-million decline in the goods and services trade deficit, a rise in net current transfers (to US\$ 915 million) and an upturn in net factor service payments. The increase in current transfers reflected an upsurge in family remittances, which totalled some US\$ 900 million, or 2.8% of GDP. Notwithstanding the high cost of remitting funds, these inflows have had a significant impact on the country's financial stability and on household consumption.

The increase in net factor service payments was due both to interest on external liabilities—despite the low level of international interest rates—and to the repatriation of profits generated by foreign direct investment on the island. The size of the negative factor-services balance in relation to the Cuban economy (2% of GDP) has turned it into a structural balance-of-payments problem. Given the acute shortage of foreign exchange, this problem makes it necessary to adjust other components of the current account, such as by increasing exports or curtailing imports.

The negative balance of trade in goods and services again diminished (by 18.6%), as export value (up by

18%) rose faster than import value (up by 12%). The sale of services abroad, mainly in the areas of tourism and telecommunications, increased by 12.8%, although transport became more expensive as a result of higher fuel and insurance prices.

The narrowing of the merchandise trade gap was due to an improvement in the terms of trade (6.4%), as growth in the volume of merchandise imports (7%) outpaced the increase in the volume of merchandise exports (6%). International prices for the country's main exports (sugar and nickel) rose in response to the upturn in global economic activity (especially in the Asian countries), which stimulated commodity purchases.

Export growth was based more on price than on volume. Both sugar and nickel were exported at higher prices, but the volume of sugar exports went down while the volume of nickel exports went up. Non-traditional exports grew further, driven especially by high-value-added exports such as biotechnology and pharmaceutical products. Cuban biotechnology has generated more than 600 patents for new and innovative products such as vaccines, recombinant proteins, monoclonal antibodies, medical equipment with specialized software and diagnostic systems. In 2003 exports of these products increased by 13% and included some new items, such as haemophilus vaccine (for the prevention of childhood meningitis and pneumonia) and colony-stimulating factor and R3 monoclonal antibody (for cancer treatment). Sixty more new products were still at the research stage and technology transfer operations were under way for the construction of production facilities abroad.

External sales of non-traditional products increased by 23% in 2003, but accounted for only about one fourth of total merchandise exports.

Efforts to develop competitive merchandise exports continue to come up against obstacles such as high production and transport costs, the high prices and poor quality of local inputs, the scarcity of integrated financing programmes, the difficulty of obtaining bank loans, the overvaluation of the official exchange rate, cumbersome customs procedures and delays in the payment of customs drawbacks.

In 2003 gross income from international tourism rose by 16% after having declined in the preceding biennium. The upturn reflected a 12.7% increase in the number of visitors (to a total of 1.9 million people) and a 4% increase (to 41,600 units) in the number of rooms available. Most of these visitors came from Canada (23.7%), Italy (9.3%) and France (7.6%). The euro's higher purchasing power helped to boost the number of visitors from European countries (by 6.5%).

The import substitution process made it possible to reduce the oil bill and increase the proportion of Cuban inputs for international tourism (69%, compared to 68% in 2002) and Cuban products sold in dollar shops (49%).

Purchases of food and agricultural products from the United States amounted to US\$ 344 million in 2003, compared to US\$ 165 million in 2002. Better prices were obtained in view of this supplier's geographical proximity.

The capital account showed a surplus of US\$ 200 million, which was enough to finance the current account deficit and slightly swell international reserves (US\$ 45 million). Lastly, the external public debt stock (US\$ 11 billion, or 34.8% of GDP) increased marginally because the euro and the yen, in which most of Cuba's liabilities are denominated, appreciated somewhat against the dollar.