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UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

SANTIAGO, CHILE, DECEMBER 1988

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LC/G.1537-P

December 1988

Notes and explanation of symbols

The following symbols are used in tables in the *Review*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank space in a table means that the item in question is not applicable.

A minus sign (-) indicates a deficit or decrease, unless otherwise specified.

A point (.) is used to indicate decimals.

A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.

Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.

Reference to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated.

Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates.

Individual figures and percentages in tables do not necessarily add up to corresponding totals, because of rounding.

UNITED NATIONS PUBLICATION

ISSN 0251-2920

CEPAL

Review

Santiago, Chile

Number 36

CONTENTS

International competitiveness: agreed goal, hard task. <i>Fernando Fajnzylber.</i>	7
Industrial revolution, technological paradigm and regional alternatives. <i>Hugo J. Nochteff.</i>	25
Technical change and productive restructuring. <i>Eugenio Lahera.</i>	33
Notes on microelectronic automation in Brazil. <i>José Ricardo Tauile.</i>	49
Exports and industrialization in Argentina, 1973-1986. <i>Daniel Azpiroz and Bernardo Kosacoff.</i>	61
Rural social policy in a strategy of sustained development. <i>John Durston.</i>	83
Interaction between the public and private sectors and the overall efficiency of the economy. <i>Juan M.F. Martín.</i>	101
Cuba's convertible currency debt problem. <i>A.R.M. Ritter.</i>	117
Food security: trends and impact of the crisis. <i>Alexander Schejtman.</i>	141
Economies of difficult viability: an option to be examined. <i>Arturo Núñez del Prado.</i>	161
The genesis of import substitution in Latin America. <i>Richard Lynn Ground.</i>	179
Some recent ECLAC publications.	205

Cuba's convertible currency debt problem

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In the decade of the 1980s, Cuba has confronted a worsening debt problem in terms of convertible currency and in the context of its participation in the world economy. Before 1985, the debt problem appeared to be manageable, indeed it did not seem to be seriously damaging to Cuba's macroeconomic growth performance, which was strong from 1981 to 1985 in contrast to most other developing country debtors, which underwent profound economic contraction in this period.

By 1986, however, the convertible currency debt problem appeared to have entered a new phase. It became clear in that year that Cuba could no longer avoid austerity and economic contraction as a result of, and requirement for, dealing with the debt. In retrospect, it appears that the real severity of the debt problem had been obscured and avoided from 1980-1985 by temporary factors which strengthened the balance of trade situation. With the weakening of these factors in 1986, the genuine character of the debt problem became apparent.

In this study the origins, dimensions and impacts of the debt problem are examined first. The debt renegotiations, and particularly those of 1986-1988, are then analysed in the context of the macroeconomic and external situation at the time. Cuba's policy response to the 1986-1988 crisis is examined, and finally the situation in 1988 is outlined and the policy options are assessed.

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Introduction

In the decade of the 1980s, Cuba has confronted a worsening debt problem in terms of convertible currency and in the context of its participation in the world economy outside the Council of Mutual Economic Assistance (CMEA) grouping. This convertible currency debt grew rapidly in the 1970s for a variety of reasons but it was not until the 1980s that it began to create serious difficulties for Cuba. In the first half of the 1980s, the debt was of continuous concern and required rescheduling three times. Before 1985, the debt problem appeared to be manageable. Indeed, it did not seem to be seriously damaging to Cuba's macroeconomic growth performance, which was strong from 1981 to 1985 in contrast to most other developing country debtors, which underwent profound economic contraction in this period.

By 1986, however, the convertible currency debt problem appeared to have entered a new phase. Despite previous reschedulings, a deteriorating balance-of-payments situation made servicing the debt difficult in 1986, so that a fourth round of negotiations was initiated by Cuba in that year. Cuba suspended payment on the debt on 1 July 1986 pending successful completion of the negotiations. At the same time, it became clear that Cuba could no longer avoid austerity and economic contraction as a result of, and requirement for, dealing with the debt. In retrospect, it appears that the real severity of the debt problem had been obscured and avoided from 1980-1985 by temporary, reversible, and somewhat unnatural factors which strengthened the balance of trade situation. With the weakening of these factors in 1986, the genuine character of the debt problem became apparent. By 1987, the magnitude of the convertible currency debt was approximately US\$5.6 billion out of a total debt of about US\$13.8 billion.

The objective of this essay is to describe and analyse Cuba's convertible currency debt problem in the 1980s, with special emphasis on the 1986-1988 period. The origins, dimensions and impacts of the debt problem are examined first. The debt renegotiations, and particularly those of 1986-1988, are then analysed in the context of the macroeconomic and external situation at the time. Cuba's policy response to the 1986-1988

crisis is examined. Finally the situation in early 1988 is outlined and the policy options are assessed.

Before proceeding with the central part of this analysis, some preliminary comments are required on the dual character of Cuba's participation in the international economy, in order to explain why a distinction is drawn in balance of payments and debt accounting practices between its relations with the CMEA grouping in non-convertible currencies, and those conducted in convertible currencies with the rest of the world. Cuba's explanation of the apparent paradox concerning its commitment to honour its own foreign debts while advocating a repudiation of the debts incurred by other countries of Latin America and the rest of the Third World is also summarized in this introduction.

Cuba keeps two sets of balance of payments accounts and two sets of debt statements. One set is in convertible currencies and includes trade and financial interactions with non-CMEA countries and any trade conducted in such hard currencies with CMEA countries. Some socialist countries, such as China and Yugoslavia, are treated for accounting purposes as being largely or partly in the convertible currency area, but counter-trade arrangements with non-CMEA countries (e.g., Spain) are also included within the convertible currency area. By 1986, 15.3% of Cuba's total trade was in convertible currencies and 13.8% was with the market economies (so that the correspondence between these two was high but not complete). These proportions represented substantial declines during the 1980s in trade in convertible currencies and with market economies, which were in the regions of 24-25% and 22-25% respectively in 1980-1981 (see table 7 below and Comité Estatal de Estadísticas (CEE) 1985, table XI.7).

The keeping of two sets of accounts reflects the dual character of Cuba's international economic relations. Cuba's trade and financial relations with the CMEA grouping are conducted largely in non-convertible currencies, although there are mechanisms for clearing payments imbalances among countries within the grouping. The pricing of major commodities and manufactures exchanged in the CMEA is usually not based on or linked closely to world price levels.

Moreover, the terms and conditions of Cuba's convertible currency debt differ sharply from those for its debt with the USSR and other East European countries. Whereas the various forms of convertible currency loans were obtained on the commercial terms and conditions prevailing in the developed market economies, the terms of lending from the USSR have been particularly lenient. Commercial credits from the USSR bear a 4% rate of interest with a 12-year amortization, while the terms for financial credits are 2% and 25 years. Repayment of both types of loans can be in goods and services, and has been highly postponable in practice (Banco Nacional de Cuba (BNC) 1982, p. 15; Rodríguez, 1986a, p. 57). (Repayment of Soviet loans has in fact been postponed on a number of occasions, and now is to begin in 1990.) These differences in lending practices and terms constitute a further reason for treating the CMEA debt and the convertible currency debt separately.

For purposes of dealing with its creditors (including banks, governments and enterprises) in the convertible currency area, Cuba has made public its convertible currency debt situation since the early 1980s. On the other hand, the debt situation with the Soviet Union and the other CMEA countries is "classified" information. Cuba has argued that this information is in any case of no concern to the international financial community of the non-CMEA world in analysing and renegotiating the country's convertible currency debt. For this reason, Cuba's convertible currency debt situation can be analysed in detail on the basis of publicly-available information, whereas the debt situation with the CMEA countries can only be the subject of estimation and speculation at this time, due to the policy of official secrecy concerning it.

Finally, a few words are appropriate on the apparent contradiction of advocating debt repudiation for the rest of Latin America while emphasizing Cuba's willingness to pay its own debt. As is well known, President Castro has been a frequent and vociferous advocate of debt repudiation by Third World countries, particularly from 1984 to 1986 (Castro, 1985a; 1985b; 1987). At the same time, he has emphasized

Cuba's commitment to fulfill its financial obligations and repay its debt: "...we are the only ones (in Latin America) who can pay the debt and who want to pay the debt, who have the will and the possibility ..." (cited in Rodríguez, 1986a, p. 54) (see also Castro, 1987, pp. 144-150; BNC, 1986a, p. 19). This paradox has been seen outside Cuba as a policy contradiction, or perhaps even as a form of official hypocrisy. (See, for example, the *Wall Street Journal*, May 30, 1985; *New York Times*, July 28, 1985.) However, the Cubans consider that the character of Cuba's borrowing is different from that of the rest of Latin America (Castro, 1987, pp. 147-148). Cuba's borrowing, it is claimed, was not from commercial banks in the United States, but "with banks which challenged U.S. pressures, and included other credit sources from developing countries". Moreover, Castro has emphasized that Cuba's credits were invested in productive development projects or in social programme and were not misspent, nor did they permit capital flight on the part of local élites (Castro, 1987, p. 148). For these reasons, President Castro has stated that "we have always

proposed to fulfill our (debt) obligations to the extent it is possible to do so" (Castro, 1987, p. 147). At the same time, and despite the fact that Cuba faces terms and conditions on its convertible currency debt similar to those facing other Latin American debtor countries, President Castro argued that Cuba had a moral obligation to speak out on behalf of the other Latin American debtor countries, advocating a form of debt forgiveness or repudiation. This obligation existed because—at least until 1986—Cuba's growth performance was strong in contrast to the situation in the rest of Latin America (see table 7 for relative growth performances). Cuba's economy was strong, in Castro's view, because of its integration within the CMEA system and the favourable trade and financial environment which the socialist bloc provided (and which President Castro characterized as a type of new international economic order) (Castro 1985a, p. 168). It would have been difficult to convince President Castro in 1985 that there was a problem with respect to his country's convertible currency debt. This situation has probably changed in the 1986-1988 period, however.

I

The build-up of the convertible currency debt in the 1970s

Cuba's convertible currency debt was small at the beginning of the 1970s, amounting to Cu\$291 million in 1969. It grew rapidly from 1969 to 1979, however, at a compound average rate of 27.4% per annum, to reach a level of Cu\$3 267.3 million in 1979 (see table 1). Although precise information for the 1970s on debt service and convertible currency foreign exchange earnings (which differed somewhat from foreign exchange earnings with the market economies) is not available, there was no serious problem with debt service. When sugar prices declined from their 1974-1975 highs to lower levels from 1977-1979, however, debt service became somewhat more onerous. Nevertheless, even though the debt situation was attracting some attention

in this period (see, for example, Economist Intelligence Unit (EIU), 1977-1979) foreign bankers and official lenders remained willing to expand their lending.

This rapid expansion of convertible currency debt in the 1970s was the result of some factors which were specific to Cuba's situation as well as to other general factors originating in the functioning of the international economy and having similar effects on many developing countries. Because these have been analysed elsewhere recently (Turits, 1987, pp. 164-167) they can be summarized quickly here.

Cuba emerged in the early 1970s from what might be considered as a period of economic irrationality in the 1960s, characterized by exces-

sive centralization in economic organization, excessive and/or premature reliance upon "moral incentives" accompanied by a counter-productive de-emphasis upon material incentives, and excessive concentration on sugar production which in effect sacrificed other sectors in order to attain the 10 million ton target (Ritter, 1974). By the early 1970s, a concerted effort was made to reorchestrate the functioning of the economy on the basis of more "rational" economic criteria. Not surprisingly, economic performance in terms of growth improved: cumulative per capita GDP increased by a total of 64.5% from 1972 to 1978, while it may have declined by as much as a total of 9.5% from 1964 to 1972, according to estimations by Brundenius (1984, p. 40). (This rapid growth was also a partial result of some years of very high world "free market" sugar prices in 1974-1976.) In view of the new orientation of economic organization, strategy and policy, together with the strong growth performance it was generating, Cuba became an attractive borrower from the

perspective of commercial banks and bilateral official lenders.

At the same time as Cuba's credit-worthiness underwent dramatic improvement, the commercial banks of the market economies, flush with petrodollars for relending by 1974, began to market their loans aggressively to middle-income developing countries. Cuba was included as a good creditor in this drive to "recycle petrodollars". Official bilateral lenders were also anxious to expand their loans to Cuba to finance Cuba's imports of machinery and equipment, especially in periods of slack activity in their own national capital goods industries.

Meanwhile, Cuba's planners had become significantly more ambitious in their investment programming following the rapid recuperation of the Cuban economy in 1972 and 1973 after the problems of the late 1960s. Gross investment rose from 12.1% of Gross Social Product in 1970 to 17.2% in 1974, increasing from 668.5 million current Cu\$ in 1970 to 1 644.8 million Cu\$ in 1974 (NBC, 1975, p. 24). As has occurred in

Table 1

CUBA: TOTAL DISBURSED DEBT IN CONVERTIBLE CURRENCY AND INDICATORS OF DEBT BURDEN, 1969-1987

Year	Total debt			Total debt per capita (current pesos)	Total debt as percentage of GSP (percentage)	Debt services ^a	
	Current pesos ^b (millions)	Current U.S. dollars (millions)	Annual change in current pesos (percentage)			Interest only (percentage)	Interest and principal (percentage)
1969	291.0	291	-	34.3	-	...	...
1975	1 338.0	1 632	1969 to 1975 29.0% p.a. 1975 to 1978 29.2% p.a.	142.9	2.1	...	...
1978	2 883.8	3 845		297.7	17.5	19.2	57.7
1979	3 267.3	4 476	13.3	335.0	19.2	19.4	45.3
1980	3 226.8	4 545	-1.2	332.9	18.3	17.7	28.7
1981	3 169.6	4 064	-1.8	325.0	14.3	19.3	35.9
1982	2 668.7	3 140	-16.5	271.0	11.6	21.0	64.7
1983	2 789.7	3 207	4.5	280.5	11.5	20.1	...
1984	2 988.8	3 321	7.1	297.6	11.5	16.5	...
1985	3 621.0	3 936	21.2	356.7	13.5	17.4	41.8
1986	3 870.4	4 663	6.9	379.4	14.1	21.7	67.8
1987 (Sepr.)	5 555.1	5 555	43.5	536.7	21.0	...	...

Source: Equipo de Investigaciones sobre Economía Cubana, 1985, p. 55, for 1969 and 1975 debt totals; other figures are taken or calculated from information in tables 2 and 3.

^a"Debt service" is defined as i) interest and ii) interest plus principal as a percentage of total exports of goods and services in the convertible currency area.

^bThe total debt figures in current Cuban pesos are translated into current U.S. dollars using the official exchange rates from table 7.

many countries facing short-lived commodity price booms, it seems to have been difficult to phase down investment and import plans quickly enough after a commodity price decline. This is due perhaps to expectations that commodity prices have ratcheted up to a new level, and to the lagged momentum of actual imports *vis-a-vis* the decision to proceed with specific investment projects. Furthermore, there was a strong inclination on the part of the Cubans to diversify and perhaps to improve the importation of technology embedded in capital goods by increasing imports of these from the market economies (Turits, 1987, pp. 165-166).

The expansion of convertible currency lending to Cuba in the 1970s was probably a significant factor contributing to the impressive growth of the Cuban economy in that decade because it permitted the importation of capital goods from the market economies. By 1978 and 1979, the debt service burden had built up to

high levels —about 58% and 45% of export income respectively, if both interest and principal are included in the debt service concept (see table 1). However, with a renewed sugar price boom on the world free market in 1980 and 1981 (28.7 US cents and 17.0 US cents per lb. respectively, International Sugar Agreement quote, annual average), Cuba's convertible currency exports recovered and reached record levels. This resulted in a major reduction in the debt service burden, despite higher interest rates. This sugar price boom, in effect, outweighed and camouflaged the steadily deteriorating debt burden in terms of rising interest payments and amortization from 1978 to 1981 (see table 1).

By 1979, the convertible currency debt was composed principally of commercial bank loans (59.8%) and official export credits (31.3%). Suppliers' credits —on onerous terms— and development assistance credits —usually on easy terms— were relatively insignificant.

II

The debt situation, 1980-1985: manageable but deteriorating

In the first half of the 1980s, Cuba's convertible currency debt problem appeared to be under control. The total value of the debt actually declined from 1979 to 1982, and when difficulties emerged from 1982 to 1985, negotiations with creditors led to successful reschedulings. Economic growth was buoyant from 1980 to 1985, averaging 7.3% per year (see table 7) despite the problems created by servicing the debt under harsh (convertible currency) balance-of-payments circumstances. The underlying debt and balance-of-payments situation was not really improving, however.

1. *The evolving debt/balance-of-payments situation*

In 1980 and 1981, the debt situation *vis-a-vis* the balance of payments presented little difficulty. The capital and current accounts, each taken

separately, were in balance to a surprising degree; the imbalances that existed offset each other, so that there was virtually no change in convertible currency reserves in either year (see table 2). In both these years buoyant service exports (mainly tourism) and sugar sales counterbalanced imports and interest payments. On capital account, net repayments of long-term capital were close to net inflows of short-term capital. Already the payments problem of the 1980s had begun, however, because this payments balance depended upon export earnings which were unsustainably high as a result of abnormally good "free market" sugar prices in those years.

Cuba's convertible currency debt/balance-of-payments problem became severe in 1982. The immediate cause of the crisis in that year was the reduction of short-term loans and deposits, which declined by Cu\$578 million between

Table 2
CUBA: BALANCE OF PAYMENTS IN CONVERTIBLE CURRENCY, 1978-1987

(Millions of current pesos)

Year	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987
Current account										
Exports										Jan.-Sept.
Sugar	595	680.3	1 247.7	1 405.8	1 355.9	1 233.9	1 135.7	1 244.4	907.3	716.8
Petroleum reexports	...	...	...	866.3	648.3	263.2	250.0	171.2	209.9	...
Other	...	...	142.7	151.4	262.1	497.7	484.4	526.9	248.5	...
Imports	...	...	...	388.1	445.5	473.0	401.3	546.3	448.9	...
Of which, sugar	-731	-581.4	-881.2	-1 121.5	-750.0	-792.7	-1 063.2	-1 177.4	-1 070.9	-735.0
Trade balance	...	...	...	...	14.1	33.6	-101	-106.4	-89.6	...
Services	-136	98.9	366.5	284.3	605.9	441.2	72.5	67.0	-163.6	-18.2
Exports of services	148	227	237	344	266.6	285	314.6	294.0	296.3	...
Imports of services	-541	-464	-651	-577	-573.0	-464.2	-608.6	-870.9	-531.5	...
Of which, interest	-143	-176	-263	-338	-340.6	-248.2	-240	-268.0	-261.6	...
Balance	-393	-237.8	-412.5	-234.3	-306.5	-179.2	-294.0	-576.9	-235.2	-530.6
Unilateral transfers	6	-	2	0.5	-2.4	0.7	9.9	4.1	1.2	-1.2
Current account balance	-523	-138.9	-46.0	50.5	297.1	262.7	-211.6	-505.8	-397.6	-550.0
Capital account										
Short-term capital										
Disbursements	165	173	134	303	118.0	...	...	348.3	325.1	...
Repayments	-67	-126	-58	-139	-521.8	...	...	-154.5	-437.8	...
Net	98	47	76	164	-403.0	-166.9	-31.8	+193.8	-112.7	-42.4
Long-term capital										
Disbursements	606	187	80	26	29.4	...	...	580.1	482.9	...
Repayments	-219	-101	-96	-142	-165.7	...	...	-220.0	-116.4	...
Net	387	86	-16	-116	-136.3	93.3	137.8	+360.1	+366.5	605.6
Capital account balance	484	+133	60	-52.0	-539.3	-73.6	+106.0	553.9	+253.8	563.2
Change in reserves	-39	-5.9	+14	-1.5	-242.2	+189.1	-105.6	+48.1	-143.8	+13.2

Source: Banco Nacional de Cuba, *Informe económico*, Havana, May 1987, for 1985-1986; Banco Nacional de Cuba/Comité Estatal de Estadísticas, *Cuba: Informe económico trimestral*, Havana, September 1987, for 1987; Banco Nacional de Cuba, *Informe económico*, Havana, March 1986, for 1984; Banco Nacional de Cuba, *Informe económico*, Havana, February 1985; Banco Nacional de Cuba, *Informe económico*, Havana, March 1984, for 1982; Banco Nacional de Cuba, *Informe económico*, Havana, August 1982; Equipo, 1985; ECLAC, *Notas para el estudio económico de América Latina 1982: Cuba* (E/CEPAL/MEX/1983/L.22/Rev.1), Mexico City, October 1983, p. 40, for 1978-1981; Comité Estatal de Estadísticas, República de Cuba, *Anuario estadístico de Cuba, 1983*, Havana, 1986, table XI. 15.

December 1979 and August 1982 (BNC, 1986c, p. 5). This reduction in Cuba's convertible currency liquidity occurred for no obvious reason and was without economic justification in the view of the National Bank, because Cuba had been honouring its financial commitments (BNC, *ibid.*). This heavy short-term capital outflow resulted in a large capital account deficit which could not be fully covered by the current account surplus of that year. While the apparently artificial net outflow of short-term capital looked suspiciously as if it had had political origins, there is little doubt that other lending in 1981-1982 was obstructed and cancelled due to actions of the United States, which was tightening the financial element of its embargo on Cuba (EIU, 1981,2; 1981,3). Compounding the difficulties were a decline in sugar export earnings (offset to some extent by increased petroleum reexports and other exports) and very high interest rates in 1982.

Largely as a result of the decline in short-term bank loans and deposits, Cuba sought a debt rescheduling with its convertible currency creditors. Cuba's initial proposals, summarized in table 6, called for a multiyear rescheduling of all long-term debt maturities falling due in 1982-1985, including both official and commercial bank creditors. A 10-year repayment period was proposed, including an initial three-year grace period. Short-term bank loans were not included in the rescheduling on the assumption that such facilities would not be withdrawn at short notice. Cuba also offered to assume a number of other commitments in its proposal:

- to restrict and if necessary to sacrifice overall economic growth in order to increase convertible foreign-exchange-earning exports and to guarantee essential consumption and medical attention for the population;
- to emphasize productive investment for import-substitution purposes;
- to continue the diversification of Cuba's international economic relations with developed market economy countries (DMEs) and less-developed countries (LDCs);
- to promote the exportation of services such as construction.

The agreements reached with official and commercial bank creditors differed from the Cuban proposal mainly in that they covered only

long-term debt maturing from September 1982 to December 1983, whereas Cuba had proposed that the debt maturities for the whole 1982-1985 period be included. This meant that the amount rescheduled was small compared to Cuba's request. It also meant that if external factors did not improve, further reschedulings would be necessary. This eventuality was anticipated and a "Good Will" clause was included in the agreements to facilitate renewed negotiations and rescheduling.

In 1983 and early 1984, Cuba's balance of payments and debt performance continued to be impaired by a number of circumstances in the international economy. These prompted Cuba to avail itself of the "Good Will" clause and to seek the rescheduling of the long-term debt maturing in 1984. Among these circumstances were the following:

- due mainly to climatic factors, sugar production fell, and due to priority sales to non-convertible currency markets, less was available for export for convertible currency (1.34 million metric tons) (BNC, 1984b, p. 16). With sugar prices more or less unchanged, earnings fell by Cu\$385 million;
- interest rates continued to be relatively high, so that relief on this item was reduced;
- net repayments of short-term capital were rather high.

However, the payments situation seemed relatively healthy in 1983. Convertible currency exports of goods and services remained stronger than one would have expected in the light of sugar prices, and the current account surplus exceeded the capital account deficit, so that international monetary reserves increased by Cu\$189 million. Cuba also maintained a growth rate in real terms of 4.9% in 1983 despite the reduction in sugar production.

In the 1984 negotiations, Cuba sought and obtained some improvement in rescheduling conditions (see table 6) so as to be on a par with the general 1983/1984 rescheduling terms available for the rest of Latin America (ECLAC, 1985, p. 19).

Cuba again sought debt rescheduling in 1985 under the "Good Will" clause, even though the balance-of-payments situation in 1984 was reasonably solid and the Gross Social Product grew by 7.2% (real) that year. Although sugar prices

Table 3

CUBA: FOREIGN DEBT IN CONVERTIBLE CURRENCY

(Millions of current pesos)

Year	1979	1980	1981	1982	1983	1984	1985	1986	1987
									Sept. 30
Total disbursed debt	3 267.3	3 226.8	3 169.6	2 668.7	2 789.7	2 988.8	3 621.0	3 870.4	5 555.1
Official bilateral	1 279.9	1 353.6	1 293.7	1 275.8	1 332.5	1 578.7	1 820.4	1 627.8	2 464.8
Intergovernmental loans	236.4	278.7	221.4	198.7	191.7	174.3	135.9	112.8	145.7
Credits for development assistance	21.4	28.3	27.2	28.2	27.4	27.1	32.2	41.2	60.0
Export credits with									
government guarantee	1 022.1	1 046.4	1 045.1	1 048.9	1 113.3	1 377.3	1 652.3	1 473.9	2 259.1
Official multilateral	-	7.9	15.2	18.2	25.0	17.2	21.5	18.0	22.3
Suppliers' credits	33.2	27.0	33.4	46.8	96.7	228.5	433.2	861.7	1 184.7
Financial institutions	1 952.6	1 837.1	1 826.4	1 327.3	1 334.9	1 164.2	1 345.7	1 362.8	1 883.1
Bank loans and deposits	1 927.7	1 800.8	1 787.2	1 277.0	1 284.5	1 076.5	1 237.9	1 199.2	1 643.0
— Medium and long-term	658.6	562.9	505.3	416.8	495.2	453.6	495.5	457.0	615.0
— Short-term deposits	1 269.1	1 237.9	1 281.9	860.2	789.3	622.9	742.4	742.2	1 028.0
Credits for current imports	24.9	36.3	39.2	50.3	50.4	87.7	107.8	163.6	240.1
Other credits	1.6	1.2	0.9	0.7	0.7	0.2	0.2	0.1	0.2

Source: Banco Nacional de Cuba, *Informe económico*. Havana, March 1986, annex No. 6 for 1979-1984; Banco Nacional de Cuba, *Informe económico*, Havana, May 1987, p. 43 for 1985-1986; Banco Nacional de Cuba/State Statistical Committee, *Cuba: Informe económico trimestral*. Havana, September 1987, for 1987.

fell to very low levels on the "free market" (5.2 U.S. cents per lb., International Sugar Agreement (ISA) quote), increased exports for convertible currency helped maintain foreign exchange earnings. Merchandise imports were permitted to rise by some 34%, however, so that the trade surplus fell short of the services deficit, resulting in a current account deficit, and thence an overall payments deficit and reserve rundown. The rescheduling sought by Cuba was reasonably routine (see table 6). Of particular note, however, were two requests. The first of these was for reduction of tariff and non-tariff barriers by major developed market economy creditor countries, in order to promote the diversification and expansion of Cuba's exports of non-sugar commodities. The second request was for the creation of a US\$60 million fund, with half paid by Cuba and the other half by creditor countries, to finance 120 studies designed to analyse the feasibility of Cuba's exporting a variety of non-traditional exports, including sport items, steam boilers, jewellery and flowers to the creditor countries. The agreement reached with creditors was not particularly notable, and again the terms were in about the middle of the range obtained by other Latin American countries that year (ECLAC, 1985, p. 19). Moreover, only a small proportion of the total debt was covered.

As can be seen in table 2 and 3, the balance of payments and debt situation deteriorated sharply in 1985. Although exports rose somewhat compared to 1984, they were still depressed owing to the very low free market sugar price, which averaged 4.06 U.S. cents per lb. Higher petroleum reexporters and a strong expansion in other exports largely offset the low sugar prices, however. The current account was in serious deficit by over half a billion Cuban pesos, due to the deficit on services. The latter occurred despite generally falling world interest rates; unfortunately Cuba could not take advantage of these, because it was forced by the unavailability of lower-interest short-term bank credit to resort to higher-cost suppliers' credits. Of even greater importance was the appreciation of the currencies (mainly the DM, Swiss franc and the yen) in which Cuba's debt was held, *vis-à-vis* the U.S. dollar and the Cuban peso. The BNC estimated that the appreciation of the real value of Cuba's debt, together with the impact of

rigid interest rates, cost an additional Cu\$582.0 million in 1985. This caused the "Imports of Services" item in the 1985 balance of payments to rise to an unprecedented level. Surprisingly, the huge current account deficit was more than offset by increases in short- and long-term net capital inflows. For this reason, in 1985 total debt increased sharply (by 21%). Its composition had deteriorated (suppliers' credits had grown 16-fold since 1980, while export credits with government guarantee had increased by 58% since that year) and short-term bank deposits plus credits for current imports increased from their 1984 levels.

A significant proportion of the disbursed debt in this period was owed to developing country creditors. In 1983, for example, 33.8% was owed to OPEC and other LDCs, with Argentina as a major creditor (7.5% of the total debt). Of the undisbursed debt, 26.3% was committed to Cuba by other developing countries (BNC, 1984b, pp. 14-15). The major creditors among the developed market economies in 1983 were Spain (with 13.3% of total outstanding disbursed debt); France (12.1%); Japan (11.3%), and the United Kingdom (7.5%). Cuba must be somewhat unique among non-Arab Third World debtor countries in that about one-third of its debt is owed to other developing countries.

2. Underlying strengths and weaknesses of the convertible currency balance of payments

During the whole of the 1980-1985 period, there were certain strengths in the evolution of some components of the convertible currency balance of payments, but also certain weaknesses. The latter ultimately overwhelmed the former by 1985-1986. Among the improvements in the balance of payments was an expansion of "other exports" (with the exception of 1984, when drought and continuing problems with plant diseases reduced coffee as well as tobacco production). This expansion of "other exports" occurred despite continuing tariff and non-tariff barriers in most of the major convertible currency markets; despite the intensification in August 1983 of problems in marketing nickel owing to the tightening of the U.S. secondary embargo which prohibited the importation into

that country of any products including Cuban nickel; and despite the decline of export markets in other LDCs, whose foreign exchange earnings had been reduced due to the recession of the 1980s and diverted to servicing their debts. Service exports in the 1980s were strong, at least in comparison with the 1970s, largely due to increased tourism. However, the growth rate of such exports in the 1980 to 1985 period was uneven and not dramatic (4.4% per annum).

Sugar exports constituted the major problem in Cuba's convertible currency balance of payments. Sugar prices in the world "free market", always unstable, fell sharply from 1980 to 1985, and hard currency earnings from sugar exports dropped by 80% in this period (see table 2). The world free market for sugar is possibly the most pathological and indeed pernicious of international commodity markets and serves the interests of exporters badly. The pathology of the sugar market arises from the fact that major blocs of sugar importers and exporters—including the European Community and ex-Colonies in the "ACP" (Africa, Caribbean and Pacific) grouping, the United States and favoured suppliers in the Caribbean, and the USSR *vis-a-vis* Cuba—have tried to stabilize and insulate their own sugar trading relationships at relatively high prices. This has meant that supply shortfalls or surpluses within these groupings lead to net purchases or sales on the marginal world "free market" which in consequence is remarkably unstable. More serious, high prices in the internal U.S. and EEC markets have discouraged consumption (which for this and other reasons has been declining), encouraged the production of other sweeteners (artificial and corn-based), and promoted high-cost domestic sugar production. In the European Community, other forms of subsidization have also stimulated domestic production. As a result of the pricing and subsidization of sugar production in the European Community, the latter has switched from being a major net importer before 1977 (importing 2.28 million metric tons on average in 1974 and 1975) to becoming a major net exporter (over 3 million tons annually from 1981 to 1983) (UNCTAD, 1987; tables 2.9.1 to 2.9.6). This volume of net exports has helped saturate the world "free market", pushing prices to low levels from 1982 to 1988. With little

prospect of a change in the pricing and subsidization policies within these major sugar producing/consuming blocs, it is likely that the marginal "free market" will continue to be well-supplied, so that prices are unlikely to show an upward trend in the medium-term future—although periodic crop shortfalls and surpluses will continue to generate instability. Cubans have every right to conclude that the world "free market" has not worked for them, but it should also be noted that the insulation of the USSR-Cuba sugar trade contributes to the instability of the residual "free market".

One item of particular interest in Cuba's imports from 1982 to 1985 was the importation of sugar, using convertible currency. These sugar imports, purchased at the "free market" price, were then reexported in order to fulfill long-term contracts with the Soviet Union (BNC, 1985, p. 35; EIU, 1983:4). By purchasing at the free market price and selling at the FOB price to the Soviet Union, Cuba made a profit of around 750 to 900 Cuban pesos per metric ton in 1984 and 1985, and a total profit of around 750 and 1 300 million Cuban pesos in the same years. Therefore, while the sugar import item represents a "weakening" of the convertible currency merchandise trade balance in these years, in fact it permitted major gains on the inconvertible currency trade balance (see the annex for the calculations on which these estimates are based.) These estimates are in nominal pesos at official US\$/Cu\$ conversion rates, and represent an upper limit on Cuban profits. Because the nominal exchange rate is unrealistic, and because rouble earnings must be spent on imports from the USSR or other CMEA countries (whose merchandise exports often are uncompetitive in terms of price and quality), the sugar reexport profit estimates are probably excessive. It remains to be seen how long the USSR and other CMEA countries generously allow Cuba to make middleman profits of this sort.

The most dynamic component of Cuba's convertible currency export performance was the reexportation of petroleum. Petroleum reexports made up 10.8% of total convertible currency exports in 1981, rising to 42.3% in 1985. Petroleum "reexports" are permitted by the Soviet Union on the basis of an agreement which provided that if petroleum consumption and

importation were below previously planned levels as a result of conservation measures and in relation to import levels from the Soviet Union, the petroleum which was "saved" could be "reexported" at world prices and in convertible currency. Interestingly enough, the sole importers in 1983 were other socialist countries—presumably the European neighbours of the USSR (BNC, 1984b, p. 3). This did not mean that petroleum was physically transported back to Eastern Europe. Instead, the transaction was in accounting terms only, with the petroleum shipped directly to the importing country. Cuba was quite successful in reducing petroleum consumption, particularly through the completion of energy systems in the sugar mills which burned bagasse rather than petroleum products. Major efforts were also made to induce fuel conservation throughout the economy by incentive systems to reward enterprises which successfully reduced consumption (in the form of wage bonuses) and to penalize enterprises which consumed too much (EIU, 1982:1, p.8), and by various investments to improve the efficiency of energy use in major petroleum-consuming activities such as nickel mining and thermal electricity generation. Domestic extraction of petroleum also increased significantly in these years.

Under this petroleum reexport scheme, Cuba was able to obtain significant profits, which were perhaps around Cu\$105 million in

1983 and Cu\$20 million in 1984 (see annex table for the estimates). These profits (measured in pesos, but earned in hard currency) are undoubtedly greatly underestimated, because the conversion rate used for the Cuban peso *vis-a-vis* the U.S. dollar is the official rate, which is very much overvalued.

The convertible currency foreign exchange earnings accruing to Cuba under this scheme obviously strengthened the convertible currency export performance. But while real resources were undoubtedly transferred to Cuba through this device, reliance upon such an artificial arrangement is dangerous, first because world petroleum prices could decline—as they did in 1986—thereby reducing or eliminating such arbitrage profits, and second, because the arrangement could be changed by the donor country.

Cuba's external situation in 1985 ended in paradox. Despite the small surplus in the convertible currency balance of payments, the trade deficits for both the socialist and the market economies reached record levels, totalling Cu\$2 000 million (see table 7). The convertible currency debt had thus increased by 17% and its composition had worsened, although economic growth remained reasonably high and investment levels reached 15.8% of the global social product. However, strong economic growth performance was no longer sustainable in view of the severe external disequilibria.

III

The debt crunch, 1986-1988

In 1986, convertible currency exports slumped, the balance-of-payments position worsened, and the debt problem intensified. Cuba responded by suspending payment on the debt on 1 July and proposing a major multiyear rescheduling. It also implemented a set of policies designed to reduce imports through austerity, to promote efficiency by the "rectification" programme, and to continue to increase hard currency foreign exchange earnings. The result of the import shortage and the austerity measures was a

decline in overall economic growth performance in 1986 and 1987, a reduction in investment levels as maintenance of basic consumption levels was given priority, and reductions in productivity.

1. *The size of the convertible currency debt*

By 1986, Cuba's convertible currency debt situation bore some resemblance to that of the rest of

Latin America, although it was still not as burdensome as for other major debtors, and there were also some major differences. Some of the main indicators of Cuba's "debt burden" in relation to other Latin American countries are summarized in table 4. It can be seen that Cuba's total debt was eighth highest in the region in

1987. In per capita terms, Cuba's convertible currency debt in 1986 was lighter than for the main problem debtor countries, but when the debt with the Soviet Union was included, Cuba's per capita debt exceeded the Latin American average significantly. With respect to debt service (interest only) on convertible currency debt,

Table 4

LATIN AMERICA: COMPARATIVE INDICATORS OF DEBT BURDEN

	Disbursed total, 1987 ^a (millions of dollars)	Per capita external debt, 1986 (dollars)	Total debt as percentage of exports of goods and services 1986	Interest payments as percentage of exports of goods and services	
				1985	1987
Latin America	409 815	988	416	35.2	30.5
Oil-exporting countries	167 150	1 203	422	32.2	25.2
Bolivia	4 450	594	647	46.8	40.0
Ecuador	9 600	830	344	27.0	31.1
Mexico	105 600	1 241	457	36.0	27.9
Peru	15 300	738	438	30.0	22.4
Venezuela	32 200	1 956	341	26.2	26.3
Non-oil-exporting countries	242 665	875	412	37.8	33.0
Argentina	54 500	1 584	636	51.1	56.2
Brazil	116 900	775	454	40.0	34.5
Colombia	15 700	487	232	26.3	25.2
Costa Rica	3 800	1 440	269	27.3	19.3
Chile	20 510	1 686	411	43.5	26.7
El Salvador	2 250	450	247	12.9	13.2
Guatemala	2 720	328	225	14.9	16.3
Haiti	740	102	240	7.4	4.6
Honduras	3 145	637	294	16.2	16.5
Nicaragua	6 200	1 496	1 977	13.3	69.9
Panama	4 900	2 161	131	...	...
Paraguay	2 000	480	233	8.3	14.8
Dominican Republic	3 700	577	259	15.4	19.6
Uruguay	5 600	1 630	346	34.3	24.0
Cuba					
1. Convertible currency	5 555	545 (1987)	322	15.6	(21.7) 1986
2. With USSR ^b	8 200	804 (1987)	175	-	- 1986
Total ^{c,d}	13 755	1 349 (1987)	215	4.3	(4.9) 1986

Source: 1. ECLAC, *Preliminary Overview of the Latin American Economy, 1987* (LC/G.1485), Santiago, Chile, December 1987, p. 25, for all information except for Cuba.

2. Banco Nacional de Cuba (BNC), *Informe económico*, Havana, May 1987, for Cuban data.

3. Economist Intelligence Unit, *Country Profile: Cuba, 1987-1988*. London, 1987, p. 25.

4. World Bank, *World Development Report, 1987*. New York, Oxford University Press, 1987, pp. 202-203 for population estimates.

^aTotals for disbursed debt of Latin American countries are preliminary estimates by ECLAC.

^bFor the estimates of Cuba's total debts with the USSR as a percentage of "goods and services exports", only merchandise exports are included, information on trade in services being unavailable.

^cCuba's debts with other countries in Eastern Europe are excluded, so that the "Totals" for Cuba's debt indicators are underestimated.

^dThe exchange rate used for converting Cuba's peso debt to U.S. dollars is Cu\$1.00 = US\$0.73, that is, the average official exchange rate for 1987.

Table 5

CUBA: CONVERTIBLE CURRENCY DEBT, 1978-1986: NET RESOURCE TRANSFERS^a

	1978	1979	1980	1981	1982	1983	1984	1985	1986
Disbursements (inflows)	771	360	214	329	151.0	121.0	199	928.4	808.0
Outpayments									
Interest	143	176	263	338	340.6	248.2	241.0	268.0	261.6
Amortization	286	227	154	281	687.5	-1	-1	374.5	554.3
Total	429	403	417	619	1 028.1	248.2	241.0	642.5	815.9
Net flows	+342	-43	-203	-290	-877.1	-127.2	-42	+285.9	-7.9

Source: Table 2, Banco Nacional de Cuba, *Informe económico*, Havana, March 1986; ECLAC, *Preliminary Overview of the Latin American Economy, 1987* (LC/G.1485), Santiago, Chile, December 1987, p. 23.

^aDisbursements are "net" for 1983 and 1984, i.e., amortization payments are deducted.

Cuba's situation was difficult, but less so than in the case of most other countries. Total debt service, including the zero interest payments on the debt with the Soviet Union, was light compared to the other countries. On the other hand, Cuba's total hard currency debt as a percentage of hard currency exports (322%) was higher than the ratios for about half the other countries, but still below the average for the whole region (416%). A final point might be made concerning Cuba's convertible currency debt situation. From 1980 to 1986, net financial outflows in convertible currency totalled Cu\$1 261 million (see table 5). This net outflow is small relative to the net outflows of resources (net inflows of capital less net payments of interest and profits) for all of Latin America in the same period, which totalled US\$108.2 billion (ECLAC, 1987, p. 23). Nevertheless, Cuba's position in this respect was basically similar to that of the rest of Latin America.

In sum, while Cuba was not a "big league" debtor like Brazil, Mexico or Argentina, it was no longer in the same unique and favoured situation in which it had considered itself to be earlier.

2. Causal factors

The immediate source of Cuba's 1986 difficulties was the decline in the world price of petroleum, which fell by more than half in three months, from US\$26.60 in December 1985 to US\$13.20 by March 1986. This reduced the hard currency value of Cuba's petroleum reexports by almost Cu\$280 million, or by more than half, from 1985 to 1986. The situation was aggravated by the

drought which reduced the 1985-1986 sugar harvest and lowered 1986 sugar exports so that Cuba was unable to capitalize on the improvement in "free market" sugar prices (from 4 U.S. cents in 1985 to 6 cents in 1986, average International Sugar Agreement quote). Moreover Cuba's other exports declined by Cu\$100 million due to a variety of factors including drought, Hurricane "Kate" and low international commodity prices. For all of these reasons, Cuba's hard currency exports fell by Cu\$337 million in 1986. An attempt was made to cut hard currency imports in line with exports, but this was difficult because they had already been reduced to about 70% of the country's estimated requirements, and a proportion of imports had already been contracted for (BNC, 1986b, pp. 11-12).

As a result of this rapidly deteriorating situation, officials of the National Bank (BNC) decided that circumstances necessitated a new rescheduling of the convertible currency debt on a broader basis than those of the previous three years. Cuba's proposals, summarized in table 6, called for rescheduling virtually all medium and long-term debt service commitments to official creditors and commercial banks (including interest as well as amortization) which were to fall due in 1986 and 1987. This amounted to about Cu\$960 million (BNC, 1986b, p. 20). A repayment period of 12 years was requested, with a six-year grace period. Fresh funds amounting to Cu\$430 million were requested for general balance-of-payments support. The rationale for this request was that external factors—nine in all—beyond Cuba's control had caused the hard currency losses. These factors included continu-

Table 6

CUBA: CONVERTIBLE CURRENCY DEBT, RENEGOTIATIONS: A SUMMARY

	1982-1983 negotiations		1984 negotiations	
	Cuba's position (August 1982)	Agreement (1 March 1983)	Cuba's position (March 1984)	Agreement (19 July 1984)
Official creditors (Paris Club)				
Proportion of debt maturities included (medium and long term)	100% (1982 to 1985 maturities)	95% (Sept. 1982 to Dec. 1983 maturities)	100% (1984 maturities)	95% (1984 maturities)
Grace period	3 years	3 years, 10 months	5 years	5 years, 6 months
Repayment period	10 years	8 years, 4 months	10 years, 6 months	9 years, 6 months
Commercial creditors		(30 Dec., 1983)		(13 Dec., 1984)
Proportion of debt maturities included (medium and long term)	100% (1982 to 1985 maturities)	100% (Sept. 1982 to Dec. 1983 maturities)	100% (1984 maturities)	100% (1984 maturities)
Grace period	3 years	3 years, 4 months	5 years	5 years, 7 months
Repayment period	10 years	7 years, 10 months	10 years, 6 months	9 years, 6 months
Financial charges				
Interest rate	-	LIBOR + 2.25%	Reduction sought	LIBOR + 1.88%
Commission	-	1.25%	Reduction sought	0.88%
New lending request	0	0	Cu\$200 million	0
Proportion of debt covered	36% of total debt Cu\$1 057.3 million	53% of debt service	11.4% of total debt Cu\$317 million	40% of debt service
Other conditions	Short-term bank loans to be rolled over Commitment to promote exports, diversify trade ties, emphasize economic efficiency	Renewal till Sept. 1984 "Good will" clause	Confirmation of existing short-term credit levels (Cu\$800 million) by banks	Renewal till Sept. 1985

Table 6 (concluded)

	1985 negotiations		1986 negotiations	
	Cuba's position (February 1985)	Agreement (18 July 1985)	Cuba's position (April 1986)	Agreement (16 July 1986)
Official creditors (Paris Club)				
Proportion of debt maturities included (medium and long term)	100% (1985 maturities)	95% (1985 maturities)	100% (1986-1987 maturities)	100% (principal + interest '82+'83 debt due in 1980)
Grace period	L.A.m. average	6 years, 6 months	6 years	6 years
Repayment period	L.A.m. average	10 years, 6 months	12 years	10 years, 6 months
Comercial creditors		(16 Sept., 1985)		
Proportion of debt maturities included (medium and long term)	100% (1985 maturities)	100% (1985 maturities)	100% (1986-1987 maturities)	No agreement with bank creditors
Grace period	L.A.m. average	6 years, 8 months	6 years	
Repayment period	L.A.m. average	10 years, 8 months	12 years	1 March, 1988
Financial charges				
Interest rate	L.A.m. average	LIBOR + 1.5%	No change proposed	
Commission	L.A.m. average	0.38%	No change proposed	
New lending request	0	0	Cu\$430 million balance-of-payments support	
Proportion of debt covered	7.7% of total debt	29% of debt services	All medium and long-term debt service, 1986-1987: Cu\$961 million	
Other conditions	Agreement by creditor nations to lower tariffs and NTBs and promote expansion and diversification of trade	No action	Postpone 1986-1987 interest to 1992	
	Roll over of short-term bank loans granted before 1 Sept. 1982	Renewal till Sept. 1986	Debt service suspended, 1 July 1986 pending agreement	

Source: Banco Nacional de Cuba (BNC), *Informe económico*, Havana, August 1982, March 1984 and February 1985; Banco Nacional de Cuba, *Cuba: deuda externa y su proceso de renegociación*. Havana, December 1986; J.L. Rodríguez, "El desarrollo en Cuba en el contexto de la crisis económica latinoamericana de los años 80", *Temas de economía mundial*, Revista del CIEM, No. 17, Havana, 1987; ECLAC, *Preliminary Overview of the Latin American Economy, 1985* (LC/G.1383), Santiago, Chile, December 1985.

ing low sugar prices, low oil prices, continuing protectionism on the part of the developed market economies, Hurricane "Kate", drought etc. (BNC, 1986b, pp. 16-18).

Agreement was reached with the Paris Club of official creditors by 16 July 1986, but could not be achieved with the commercial banks. The agreement with the Paris Club covered a smaller volume of debt than Cuba had proposed initially. Only that debt existing in 1982 or renegotiated in 1983 and falling due in 1986 was to be rescheduled, rather than all 1986 and 1987 maturities. The Paris Club creditors did provide about 75 million pesos of fresh funds, but this was far short of the amount requested (EIU, 1987:4, p. 11). The repayment conditions were close to Cuba's initial request. Because of the failure to obtain a multiyear rescheduling, new negotiations were requested for 1987.

The rescheduling of commercial bank debt failed because the banks' proposals fell far short of Cuba's requests, and compromise was not achieved. The banks offered fresh funds amounting to DM 150-170 million (57-65 million pesos) (BNC, 1986c, p. 12) in comparison with the 430 million peso initial request. These fresh funds were to be linked to interest payments, and amounted to an interest capitalization scheme. The banks proposed to reschedule only the 1986 maturities of the debt in effect in 1982 (for 10 years with a six-year grace period), plus a two-year rescheduling of the 1986 maturities of that debt renegotiated in 1983. When these differences could not be resolved, Cuba suspended payment on both principal and interest.

3. *The policy response and results*

By early 1986, it was clear that the overall convertible currency payments imbalance was neither sustainable nor renegotiable and that a strong adjustment programme to deal with the convertible currency debt problem was necessary. The policies adopted in 1986 could be categorized under the labels "austerity", "rectification" and "restructuring for hard-currency conservation".

A detailed "austerity" policy package was presented and adopted in December 1986 at the National Assembly of People's Power. It was intended to be a complement to the Develop-

ment Plan and Budget for 1987. The austerity programme included a variety of elements designed to increase exports or reduce consumption of certain hard currency import-intensive commodities (BNC, 1986c, pp. 15-16):

- monthly import quotas of kerosene (used mainly for cooking) were to be cut in order to reduce convertible currency imports by 35 000 metric tons (or 256 550 barrels);
- 10 000 000 m² of textiles were to be diverted from domestic consumption and made available for export;
- domestic sugar consumption quotas were to be reduced in order to increase exports;
- television programming was to be reduced by 29 hours per week to save oil (used for thermal generation of electricity) in order to make 130 000 barrels of petroleum available for reexport;
- electric power rates were to be raised to reduce oil consumption and increase reexports;
- gasoline allocations for State administrative activities were to be reduced by 20% to permit more oil reexports;
- food quotas were to be reviewed and reduced, and allocations of imported foodstuffs to workers' dining rooms and day-care centres were to be cut.

Other items included increases in some retail prices, especially on the "parallel market", and higher interurban bus fares. Perhaps the most important part of the policy package was the proposal to limit hard currency imports to Cu\$600-700 million per year (far below the Cu\$1.3 billion hard currency import levels which the Cubans considered necessary). The growth rate of the economy was also to be limited to between 1.5 and 2.0% for 1987 (BNC, 1986c, p. 15). This constituted a set of self-imposed measures, as drastic as those of the IMF, aimed particularly at the convertible currency problem but also designed to improve internal finances. To moderate the impact of these measures on income distribution, the minimum monthly wage was increased from 85 to 100 pesos per month, and incomes at the bottom end of the wage scale were raised, affecting perhaps 180 000 workers. Pensions were also increased to 100 pesos per month, affecting perhaps 350 000 persons (EIU, 1987:1, p. 10). At the

same time, the official perquisites of higher-level bureaucrats, such as access to State vehicles, were cut back, and such individuals were required to buy the vehicles and cover their running costs. Similarly domestic "per diems" and hard currency foreign travel allowances were reduced. The reconsideration of work norms and salary scales under the "rectification" programme was also designed to reduce anomalous inequalities and injustices.

It is also likely that the "rectification" programme begun at the February 1986 Third Party Congress was inspired at least in part by the difficulties arising from the debt/balance-of-payments problem. This programme, intended to "correct errors" in the administration of the socialist economy but not to change its basic orientation, has emphasized i) the rationalization of work norms, wage and salary scales, bonus payment schemes and perquisite arrangements; ii) the eradication of certain corrupt practices such as in the procurement of building materials for private house construction; iii) the elimination of certain —but not all— private sector activities, notably the farmers' markets, in an effort to reduce the accrual of large incomes by middlemen and large farmers, with visibly demoralizing effects on other workers; iv) the austerity measures mentioned previously. Perhaps one of the most important results of the "rectification" programme, however, is the highly critical attitude which seems to prevail in evaluation and self-evaluation at the numerous "Asambleas del Balance del PCC" (meetings of the Cuban Communist Party for performance evaluation) held at various levels from enterprise to Ministry, and at other meetings of Ministry directors (see, for example, *Granma*, 9 February 1988, which describes a session of the annual meeting of directors of the Ministry of Basic Industry). This reawakened critical attitude should prove useful in making the current economic administration operate more efficiently (although it will not help solve systemic difficulties such as the lack of a single realistic exchange rate, the existence of which would permit export and import decisions to be made more easily and on the basis of economically realistic criteria).

The third element in Cuba's approach to the hard currency debt/balance-of-payments prob-

lem has been to promote exports of goods and services and to try to accelerate the completion of major import-substituting investments. For example, tourism, which has expanded rapidly in the 1980s and become a major hard currency earner (with 91% of its total earnings of Cu\$107.6 million in 1986 being in convertible currency (BNC, 1987, p. 20)), continues to be a high-priority sector and has received substantial new investment and critical attention. Major efforts have been put into projects to expand nickel production, which have been subject to delays so far in the 1980s but which should come on stream soon. Domestic crude oil extraction received considerable emphasis and has expanded rapidly, at a rate of 26% per year from 1980 to 1985. Recent extraction levels are 1 million metric tons (7.33 million barrels) per year, or approximately 15% of consumption (EIU 1987:4, pp. 12-13). Efforts are also being made to expand the direct use of local crude oil wherever possible, e.g. in power generation and cement making (EIU, 1987:2, p. 13). Expansion of oil extraction would be of immense value to Cuba, and now does not seem to be improbable in the light of the geological features of the Caribbean basin and preliminary surveys. The nuclear plant for the generation of electricity has been particularly slow in coming on stream. It was expected to do so in late 1985 but is still far from completion. When completed, it should save some 33% of crude oil imports (EIU, 1984:4). Emphasis on the speedy completion of all these major projects should improve the convertible currency balance-of-payments situation by the early 1990s.

Despite the actions undertaken to improve the convertible currency debt/balance-of-payments situation in 1987, the results seem to have been disappointing, although a definitive statistical picture is not yet clear. The austerity programme which was designed to improve the convertible currency foreign exchange situation was implemented quickly and effectively in 1987. Through reduction in imports and increases in exports and reexports it generated 33 million pesos worth of hard currencies in that year. It improved the State budget by an estimated Cu\$266.3 million, and it improved the "balance of income and expenditures" (i.e., it reduced net monthly income and relieved the

pervasive suppressed inflation) by some Cu\$215 million (BNC, 1988c). Unfortunately, the hard currency impact of the austerity programme was small compared with the total value of convertible currency imports and exports, so that it provided only minimal relief from the debt problem.

Investment was reduced by almost 27% in 1987 in order to reduce capital goods imports from hard currency countries (see table 7). Indeed, total investment including inventory change fell by 46.6% from 1985 to 1987 (BNC, 1988c, p. 4). The decline in investment was due largely to a reduction in the initiation of new projects, while the completion of ongoing projects was given a high priority. The cutback on investment expenditures had a major impact on the construction sector, the output of which fell by over 11% in 1987 (BNC/CEE, 1987, p. 10).

The shortage of hard currency foreign exchange also led to reduced imports of intermediate inputs as well as replacements and spare parts. This reduced levels of output in a number of areas in 1987, while the climatic disturbances of 1985-1987 contributed to the reduction in agricultural output in that year.

As a result of all of these factors—the austerity programme, the investment cutback, reduced imported inputs, and the climate—the gross social product contracted by 3.5% in 1987, or by 4.5% in per capita terms (BNC, 1988c, p. 3). At the same time there was a major decline in labour productivity (-4.7%). The resulting economic contraction was in sharp contrast with the positive growth rate of +1.5 to 2.0 which had been previously anticipated for 1987. Implementation of the "rectification" programme was well underway in that year, but this programme could not be expected to yield significant or measurable results in a period of time as short as 18 months.

The convertible currency balance of payments showed some improvement in 1987, with preliminary estimates indicating that exports rose to Cu\$990 million, an amount exceeding that for 1986 but below that for 1985 (BNC, January 1988a, p. 1.). The 9% increase *vis-à-vis* 1986 was due to some recuperation of sugar and petroleum prices and a 9% increase in non-sugar exports, while imports from hard currency areas declined somewhat. The deficit in the services

category rose sharply despite a 10% increase in hard currency tourism revenues and despite the moratorium on interest payments. The main reason for the large services deficit, and also the large current account deficit, was the fact that an allowance of Cu\$377 million had to be made for the appreciation of creditor countries' currencies or "exchange rate adjustment", which enters the balance of payments as a negative item under the trade in services. On capital account, there was a large net inflow of long-term capital, presumably representing disbursements of previously-negotiated loans, together with very low repayment of loans due to the moratorium. Overall, the payments balance is estimated to have been slightly positive for 1987 (see table 2), but it should be emphasized that this only occurred because interest and amortization payments on the debt had largely ceased.

On the other hand, the convertible currency debt picture worsened sharply in 1987. The total peso value of the debt increased by 43.5% between 1986 and 1987, or by Cu\$1.68 billion. The largest part of this increase occurred as a result of the significant devaluation of the Cuban peso used for trade and debt accounting purposes against all major DME currencies, including the U.S. dollar, which was itself depreciating (BNC-CEE, 1987, p. 29). By devaluing this exchange rate from US\$0.83 per Cuban peso to US\$1.00 per peso, about 1.1 billion pesos were added to the convertible currency debt. There is no evidence that the value of Cuba's hard currency debt as denominated in pesos was adjusted in this fashion before 1987, and it certainly was not in the 1980-1985 period, when the appreciation of the U.S. dollar would have led to a corresponding downward adjustment of the magnitude of the debt (as may be seen from table 1). Unfortunately, details on the methodology and specific rationale for tying the value of the peso-denominated debt to the value of the U.S. dollar are not available.

By the beginning of 1988, a large volume of debt arrears had been built up due to the moratorium, including Cu\$2 105 million in principal and Cu\$356 million in interest (BNC, 1988c, p. 3). With Cu\$1 212 million in principal and Cu\$505 million in interest coming due in 1988, the total value of debt repayment theoretically necessary for 1988 would be Cu\$4 178 million,

Table 7

CUBA: MAJOR MACROECONOMIC INDICATORS

	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987 (to 30 September)
Global social product (real)										
Growth rate (percentage)	7.3	1.5	-0.5	16.0	3.9	4.9	7.2	4.6	1.4	-3.5
Per capita growth rate (percentage)	6.3	0.7	-0.6	16.0	3.1	3.8	6.1	3.6	0.3	-4.5
Investment (real)										
Growth rate (percentage)	-5.5	-0.6	5.3	20.0	-11.5	+13.8	+17.0	+7.5	-10.0	-26.7
As a proportion of GSP (percentage)	14.2	13.9	14.8	15.3	13.0	14.1	15.4	15.8	-	-
Productivity change^a										
Output per worker (percentage)	-	-	-	+17.4	-1.1	+3.5	+5.6	+3.5	-2.5	-4.7
Merchandise trade (millions of Cuban pesos)										
Socialist economies:										
Exports	2 916	2 884	2 786	3 179	4 172	4 765	4 909	5 323	4 699	4 467
Imports	2 849	3 053	3 613	4 114	4 908	5 414	6 072	6 718	6 412	4 775
Balance	67	-169	-827	-935	-736	-649	-1 163	-1 395	-1 713	-308
Market economies:										
Exports	524	615	1 181	1 045	761	770	568	660	626	428
Imports	724	635	1 014	1 000	623	808	1 155	1 265	1 156	607
Balance	-200	-20	-167	+45	+138	-38	-587	-605	-530	-179
Convertible currency: balance	-136	+99	+367	+284	+606	+441	+73	+67	-164	-18
Exchange rates										
Official rate (Cu\$/US\$)	.75	.73	.71	.78	.85	.87	.90	.92	.83	1.00
Latin America: Growth rate of per capita gross domestic product (percentage) (excluding Cuba)										
			2.8	-1.9	-3.7	-4.8	1.4	1.1	1.4	0.5

Source: State Statistical Committee (CEE), *Anuario estadístico de Cuba*, 1985, Havana, 1986, pp. 100, 161, 193, 381; BNC-CEE, *Cuba: Informe económico trimestral*, Havana, September 1987, p. 11; BNC, *Informe económico*, Havana, May 1987; ECLAC, *Preliminary Overview of the Latin American Economy, 1987* (LC/G.1485), Santiago, Chile, December 1987; ECLAC, *Preliminary Overview of the Latin American Economy, 1985* (LC/G.1383), Santiago, Chile, December 1985.

^aChange in gross output per worker, at constant 1981 prices, prices at enterprise, and average workers per year.

that is, about 400% of the hard currency foreign exchange earnings for 1987. Clearly this is an impossible task under any foreseeable balance of payments scenarios for 1988. It was in this context that Cuba again approached the Paris Club of creditors in January 1988. At these meetings, the Government of Cuba requested that virtually all official bilateral credits maturing in 1987 and 1988, together with interest due but not paid before 31 December 1988, be rescheduled for 15 years including a 5-year grace period. By mid-March 1988, agreement had not been reached.

4. *Prospects and policy options*

Cuba's convertible currency debt and balance-of-payments situation will be difficult but no hopeless for the next few years. A major debt rescheduling is urgently required in the short term. In the longer term, a lasting resolution of the current problem will require a more ambitious adjustment or restructuring programme than has been considered so far.

The immediate difficulties in 1988 are daunting:

- foreign trade is of necessity conducted on a cash-only basis due to lack of foreign exchange and drying up of credit sources;
- the debt service burden plus arrears for July 1986 to 1988 is overwhelming, at over 400% of annual convertible currency foreign exchange earnings;
- asphyxiation of production due to shortages of imported inputs and capital goods from hard currency areas will continue to damage growth prospects;
- the lucrative petroleum and sugar reexport schemes are vulnerable to changes in tolerance of them by the Soviet Union, as well as lower prices in the case of petroleum;
- world "free market" sugar prices are unlikely to improve markedly for any length of time, unless there are major changes in bloc protectionism.

On the other hand, there are a number of factors which should have modestly beneficial impacts on the overall and the hard currency debt and balance-of-payments situations. These include:

- probable increases in tourism;
- expansion of nickel concentrate production

and exports by about 30% in terms of volume;

- probable increases in sugar production volumes, provided the weather is not inclement;
- priority investment projects in export activities (citrus packing houses, fish processing facilities, tourist hotel refurbishment, and sugar) which should assist export expansion in the medium term;
- prospective increases in petroleum extraction and refining, which should reduce oil imports and/or permit increased reexports;
- the future start-up of petroleum-saving nuclear energy generation.

Unfortunately these positive factors are of limited short-term impact, while Cuba faces an immediate liquidity shortage. The positive factors should be of some benefit in the 1989 to 1992 period, but in the meantime Cuba must obtain hard currency foreign exchange for current use.

A major rescheduling of the hard currency debt appears to be unavoidable. Such a rescheduling would stretch out payments for 1988 maturities and arrears over a long period of time. It would add significantly to the magnitude of the debt because 1988 interest and interest arrears—some Cu\$861 million in total—would be "capitalized", that is, covered by increased loans. "Interest capitalization" is unfortunate but probably necessary. Provision of "fresh money" for immediate uses would also be useful. A major consolidation of debt in the rescheduling to replace high-cost suppliers' credits with lower-cost long-term bank credits would be desirable as well.

Cuba is unwilling to place itself under the scrutiny, monitoring, or policing of the International Monetary Fund or World Bank (it is not a member of either of these agencies) or any other such body. On the other hand, the commercial banks and the public financial institutions of the Paris Club require some assurance that Cuba is undertaking internal policy initiatives which will permit it to earn hard currency foreign exchange and eventually service the debt successfully in the long run. This means that Cuba itself must design, implement and report on its own structural adjustment programme so as to satisfy its creditors. Cuba effectively performed

all of these functions in the austerity programme adopted in December 1986. As noted, that programme was well implemented, but the benefits it produced were small relative to what was needed. A more ambitious structural adjustment programme is required.

Cuba has already adopted some of the features of such an adjustment programme, including investment projects to expand exports and substitute for imports and schemes for reducing direct consumption of imported commodities. What is now necessary is a major expansion of this programme with special attention to exports and to the country's convertible currency needs. How can Cuba's hard currency export earnings and import savings be increased? This is a difficult task and one which has preoccupied Cuban policy-makers for some years. It is a task made more difficult because it requires large amounts of what it is supposed to generate, namely hard currency. In the medium term, the hard currency foreign exchange situation should improve as the various export and import-substituting projects mentioned earlier come on stream. In the longer term, export earnings (especially in hard currency) will need to be further increased if the convertible currency debt is to be serviced and worked down and if adequate levels of imports from the DMEs and LDCs are to be maintained. In this endeavour, normalization of trade relations with the United States would be useful in providing a good market for a variety of non-sugar and non-traditional exports as well as a major source of tourism. Unfortunately the termination of the U.S. embargo will be decided in Washington, not Havana, and its timing cannot at present be predicted.

A number of policies could be adopted by Cuba to strengthen its participation in the international non-CMEA economic system. These would include a continued dedication to investment projects generating or conserving hard currency, a new exchange rate policy, and a new system of linking enterprises more closely to

foreign producers in order to improve product design and quality from the standpoint of foreign purchasers. An exchange rate reform would likely involve a major devaluation, together with unification of the current multiplicity of exchange rates. Improving the linkages of enterprises with their foreign markets would involve a major decentralization of decision-making regarding product design, pricing, input procurement and marketing. If both these types of action were taken, this would imply significant movement towards decentralization and marketization. The likelihood of significant movement in these directions can only be the subject of speculation at this time, but they may not be out of the question.

In the meantime, if a major rescheduling of the hard currency debt with official and commercial bank creditors is not achieved, Cuba faces some difficult choices. Unilateral repudiation is still unlikely, even though part of the basis for President Castro's rejection of this alternative for Cuba has changed: Cuba is not and does not perceive itself to be in a strong enough economic position at this time to service the hard currency debt except at unacceptably high cost in terms of popular living standards. This being the case, the option associated with President Alan García of Peru—that is to say, to unilaterally agree to service the debt ultimately but at a reduced level—would appear to be attractive. In Peru's case, the debt service is limited to 10% of foreign exchange earnings. A variant of this approach might be appropriate for Cuba. Certain other devices might also be useful in working down the debt, including countertrade arrangements in which creditor banks accepted repayment in kind, or schemes in which creditor banks agreed to purchase additional Cuban exports for hard currency when part of the debt was repaid (ECLAC, 1987, p. 9). (Debt-for-equity swaps probably have virtually no role to play in the Cuban case, although the existence of foreign investment legislation in Cuba would indicate that such swaps may not be impossible.)

Annex

CUBA: PETROLEUM AND SUGAR REEXPORTS: PRICES, QUANTITIES AND ESTIMATED PROFITS

	1980	1981	1982	1983	1984	1985	1986	1987
Sugar								
Imports:								
Price (US\$ per lb)	.287	.170	.084	.085	.052	.041	.060	.066
Cu\$/metric ton	454.	302.	159.	163	103.	83.	110.	146.
Total value (Cu\$/million)	-	-	14.1	33.6	101.0	106.4	89.6	138.0
Quantity (thousands of metric tons)	-	-	88.8	206.0	975.0	1 419.4	812.8	945.0
Reexports: (to USSR)								
Price (Cu\$/metric ton)	759.	606	658.	873.	868.	986.	850.	850.
Quantity (thousands of metric tons)	-	-	88.8	206.	975.0	1 419.4	812.8	945.0
Profit per metric ton (Cu\$)	...	...	499.	710.	765.	903.	740.	704.
Total profit (Cu\$/million)	...	...	44.3	146.3	745.9	1 281.4	601.5	665.2
Petroleum								
Imports: (from USSR)								
Price (Cu\$/metric ton)	83.20	102.70	125.80	147.0	174.2	175	175	175
Total value (Cu\$/million)	878.6	1 139.2	1 468.0	1 824.8	2 169.7	...	...	...
Quantity (thousands of metric tons)	10 564	11 089	11 668	12 410	12 458	...	...	...
Reexports:								
Price (US\$ per barrel)	28.50	32.50	33.48	29.30	27.53	26.50	13.54	17.43
Cu\$/metric ton	150.00	191.50	210.80	186.60	181.60	180.00	82.40	127.80
Quantity (thousands of metric tons)	...	790.5	1 243.3	2 666.9	2 666.9	2 926.9	3 016.6	3 000.0
Total value (Cu\$/million)	...	151.4	262.1	497.7	484.4	526.9	248.5	383.4
Profit per metric ton (Cu\$)	...	88.8	85.0	39.6	7.4	5.0	-92.6	-47.2
Total profit (Cu\$/million)	...	70.2	105.7	105.6	19.7	14.6	-279.3	-141.6
Exchange rate used								
Cu\$/US\$	.717	.804	.859	.869	.90	.92	.83	1.00

Source: Banco Nacional de Cuba, *Informe económico*, Havana, May 1987, p. 25; Comité Estatal de Estadística, República de Cuba, *Anuario estadístico de Cuba, 1985*, Havana, 1986, p. 409; Economist Intelligence Unit, *Quarterly Economic Review of Cuba, Dominican Republic and Haiti*, No. 4, London, 1986, p. 12; Banco Nacional de Cuba/Comité Estatal de Estadísticas, *Cuba: Informe económico trimestral*, Havana, September 1987.

Notes: 1. Conversion factors used: 1 metric ton = 2 204.6 lbs; 1 metric ton of oil = 7.33 barrels.

2. The exchange rate used for currency conversions is the official rate "Contra Certificado de Divisas Indirecto", the rate used for balance of payments and debt accounting purposes. The series indicates devaluation against the U.S. dollar (which was appreciating) from 1980 to 1985, followed by a peso appreciation in 1986. In 1987 there was a major peso devaluation against the U.S. dollar despite the fact that the dollar itself was devalued that year. The fact that, at these official exchange rates, large losses on petroleum reexports were occurring but that trade was being continued only indicates that the exchange rate is seriously overvalued. With a more realistic exchange rate (e.g., US\$1 = Cu\$2) the import price of sugar would be increased and the reexport profits reduced, while the reexport price of petroleum and hence reexport profits would be increased in terms of Cuban pesos.

IV

Summary and conclusions

Cuba's convertible currency debt, which increased rapidly in the 1970s, was manageable without major difficulty from 1980 to 1985, albeit with three reschedulings. In retrospect, however, the underlying hard currency balance of payments was being strengthened somewhat artificially by petroleum reexports which were ultimately unsustainable. The rapid economic growth from 1981 to 1985 was not accompanied by sufficient improvements in convertible currency foreign exchange earnings or savings. In early 1986, the seriousness of the underlying problem became apparent, as petroleum reexports fell by over half (due to the fall in world oil prices) while other non-sugar exports also declined. Cuba was unable to service its hard currency debt, except at unacceptable cost, and therefore declared a moratorium on commercial bank debt on 1 July 1986.

Since 1986, the basic hard currency debt and balance-of-payments situation has improved very little despite a well-implemented and self-

imposed austerity programme, despite the commencement of the "rectification" process, and despite major attempts to channel investment towards foreign exchange-generating or conserving projects and towards projects nearing completion. Rates of economic growth declined, reaching -3.5% in 1987 in comparison with a targeted rate of +1.5 to 2.0% for that year. By early 1988, the situation was grave, with payments for 1988 plus arrears amounting to about 400% of expected hard currency foreign exchange earnings, and with major risks of further deterioration which appear likely to overwhelm some more positive factors in the short run. A major rescheduling is urgently required, but this had not been achieved by late March 1988. In the absence of such a rescheduling, a continuation of a unilateral repayments moratorium by Cuba may occur. However, it is more likely that Cuba may adopt a "Peruvian-style" approach in which it agrees to repay the debt, but at a level of servicing deemed reasonable in terms of Cuba's ability to pay.

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