

“The Cuban Economy at the Start of the Twenty-First Century”

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Part II. The International Context

Chapter 5. “Challenges of Cuba’s Insertion in Caribbean-U.S. Trade”

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Challenges of Cuba's Insertion in Caribbean–US Trade

by Jorge Mario Sánchez Egozcue

Introduction

This chapter attempts to identify the structural determinants of Cuba's short- and medium-term foreign trade (two to six years) with two objectives. First, from the regional perspective, it analyzes factors that favor the trend toward convergence with neighboring countries or if alternatively, Cuba will continue as a separate case, albeit with the benefits and drawbacks implied by the status quo. Second, though more uncertain, but to not less important, it examines the impact of a possible relaxation of current restrictions and the reestablishing of trade with the United States (without intending to define how one can arrive at that process). It explores how significant this commercial re-approximation with the US could be for Cuba and the Caribbean, and which would be the best alternative for Cuba: bilateral integration (i.e. Mexico, Chile)? Or its regional insertion into a Caribbean agreement?

This paper seeks to evaluate the strategic options for Cuban trade. Weaknesses and strengths at regional (Cuba-Caribbean) and bilateral (Cuba-US) levels are identified in order to orient efforts towards what is most advantageous for Cuba. Previous studies have raised similar questions but from substantially different assumptions, for example, schemes based almost exclusively on foreign assistance for an eventual reconstruction of the country as a consequence of a political transition, or a priori guaranteed access to the United States market without practical considerations. In this case a simpler and more pragmatic approach is adopted, the transformations derived from the collapse of the Socialist Bloc are assumed to be irreversible, making it critical to consider the options of integration within international and regional trends of trade and investment.

In the case of the Caribbean community of nations, the growing harmonization of policies and the increase in reciprocal trade is already taking place, the question here is how far should be advanced in that direction. Likewise a definitive shift has also taken place as a result of the awakening of interests by US businessmen in pursuing trade and investment options with Cuba and furthering recent steps towards the relaxation of bilateral trade restrictions. Shifting from being an issue with a high degree of uncertainty in the 1980s, this variable, together with tourism and remittances, has become one of the factors of greatest potential influence on Cuba's economic future. How relevant is bilateral trade with the US for Cuba? This is also one of the questions examined in this paper based on a sufficiently conservative estimate so as to measure its "minimum" probable impact.

An attentive reader will note surely that the approach of deploying an analysis based on world trends was avoided, as well as that relatively little space to historical factors and institutional inertias was granted in the paper. In the case of global patterns, the response is simple, both Cuba and the Caribbean as a whole are too small actors with respect to large scale international forces and therefore, this study focuses at the respective scale. With regard to the historic factors, this

paper tries to present an argument in which these appear as the result of applied policies and the consensus that made these possible.

II. Regional Trends: Opening and Access to Markets

Trade Openness and Economic Growth: Theories and Empirical Results

With the increase in the internationalization of trade relations, studies focused on the linkages between openness to trade and economic growth¹ have developed considerably in recent decades. The predominant view is that greater openness is correlated with greater economic growth whatever the allotment conditions, including country size, resource endowment, natural trade barriers, political environment, cultural and historical background, etc. The widely held opinion in the literature concurs that trade flows are ultimately not more than an imperfect “proxy” for trade orientation, and that tariffs and exchange rates by themselves do not capture the spectrum of real restrictions and factors that distort prices and the relationships between trade regime and economic growth.

The studies that have argued that a positive effect can be derived from openness in terms of growth include the so-called “new theories” on growth developed by Romer (1986) Lucas (1988), and, at a more empirical level Martin (1992). Along these lines, other models have shown that distortions to trade induced by tariffs and exchange rate controls act to reduce growth in small countries with limited resources, where imports are essential for production, basically by reducing per capita GDP by the share derived from distortions in exchange rates and tariffs (Lee 1993). Utilizing another approach building on the idea that countries with greater openness have better flexibility to take advantage of the technological advances generated in other nations, thus benefiting growth rates, other researchers have also argued in favor of this interpretation including Romer (1992), Grossman and Helpman (1991), Barro and Sala-i-Martin (1995) and Obstfeld and Rogoff (1996).

There are authors who have expressed either opposition to this view or questioned the impact of these variables on economic growth. Helleiner (1986) argues that a minimum level of development is required before the benefits of international trade can completely be realized. Grossman and Helpman (1991) develop a theoretical model showing that there is a negative relation between the degree of trade liberalization and growth. Krugman (1994) and Rodrik (1995) found that the effect of the degree of economic openness on growth turns out to be insignificant, or at least not as large as is postulated by other studies. In addition, the indices² utilized to measure the degree of openness have been strongly criticized with regard to their capacity to capture the entire range of causal factors that frequently do not distinguish between trade factors and those of macroeconomic policy (Rodrik 1995). One study on the variety of measures of openness in order to verify the soundness of the interrelationship between economic growth and trade restrictions found that all of the indices that were statistically significant showed a positive relation between more open trade regimes and economic growth (Harrison 1993). Other studies have addressed the subject, for example, using the growth of exports and the ratio of trade dependency as proxy variables for openness, such as Balassa (1982). The principal limitation of such indices is that they are not necessarily associated with trade policy.³

Some methods are better accepted since they are derived from more “observable” variables,⁴ the most encompassing approach is that used by Edwards (1997) in which 9 indicators for openness are analyzed for a sample of 93 countries. In the study Edwards reports that his findings concur with authors who had found previously evidence of a positive relationship between economic growth and openness to trade.⁵

Having examined this theoretical framework pointing to the merits of the liberalization of trade on economic growth, this chapter departs from the premise that Cuba’s accession to trade with the Caribbean and other regions potentially promises to yield long-term benefits for the country’s overall growth strategy. However, at the same time, as the aforementioned literature also has noted, trade levels and strategies must be decomposed in order to understand how overall trends translate to the cases of particular countries, such as the case of Cuba.

Cuba and the Caribbean: Commonalities and Divergences⁶

The economies of the Caribbean Basin all share a similar profile with regard to size, income level, as well as their most important economic sectors and commercial structures. However, a more detailed comparison shows important asymmetries. Some Caribbean countries are extremely dependent on oil revenue as their primary source of income, others on financial services, and still others on tourism, or the export earnings from raw materials and food. Within the set, Cuba has certain advantages. For example, its size is relatively large to the regional average.⁷ It has advantages in terms of the size of its merchant and aviation fleet and its capability to be utilized in intraregional trade. In addition, the general qualification level of its work force is relatively high, as well as the size of its domestic market.

Nevertheless, certain unique characteristics prevent Cuba from being analyzed homogeneously with other countries in the region. Such is the case of the heterogeneity in the development of its financial and tourism industries, restricted access to foreign borrowing, domestic financial systems, as well as structural economic differences. For example, of the nine procedures that form the Caribbean Single Market Economy (CSME) project⁸, the most difficult factors in the short-term are those linked to the criteria for fiscal convergence, exchange rate stability and international reserves due to the heterogeneity in policies and macroeconomic conditions. These differences are particularly significant in the case of Cuba, because its disparities with respect to the region on macroeconomic policy and market orientation are stronger. Nevertheless these forces are likely to change with Cuba’s membership in the Association of Caribbean States (ACS), which should act as the natural bridge toward deeper integration in the Caribbean’s free trade area. If this happens, there is consensus that Cuba’s full insertion into the agreement could bring significant implications on the region over trade and investment flows.

In terms of trade, the level of access Caribbean countries, other than Cuba, have to the US market is particularly relevant. This is strongly influenced by means of US initiatives or special clauses that provide guarantees and preferential treatment for the region that would normally be unavailable in the international market. These factors, to a greater or lesser extent, condition the probability that a pattern of “convergence” in terms of trade and regional investment with respect to Cuba’s insertion will take place in the short-term, and in the same way, are key determinants upon evaluating the strategic options derived from Cuba’s trade scenarios with the US.

Before undertaking a more detailed analysis of Cuba's trade strategies, it is first necessary to characterize the principal special features of the economies in the Caribbean and their comparison to Cuba with respect to factors such as size, income levels, economic sectors, growth patterns and trade structures of the countries in the region in greater depth. This is the purpose of the next sections of this chapter.

Size

The larger countries in the region⁹ are Haiti, the Dominican Republic, and Cuba, each with a level of population between 7–11 million inhabitants. However, these same countries are located in the bottom smallest third of countries at the world level classified by population. Nine of the fifteen economies in the region have population levels below three hundred thousand inhabitants. Accordingly, what is characteristic of these economies is their *small size, which is below the world average and lower than the average for developing countries*. At the regional level, Cuba stands one of the larger countries given its population and geographical surface area, which in principle permits it to have advantages in terms of having a more responsive impact on the flows of trade, investment, and services.

Size not only is important from the perspective of the regional integration, but also influences the establishment of trade agreements with other regions or partners. On the other hand, Cuba has not participated in almost any of the trends in regional trade for the last thirty years. Upon not having access to the US market, it also remained excluded from all the modalities of collective agreements (such as the Brady Plan, and the Caribbean Basin Initiative and the more recent law, United States-Caribbean Basin Trade Partnership Act). It has also not participated in the CARIBCAN agreement initiated in 1986 with Canada that permits duty free access to 7.5% of the Caribbean's' exports, nor in the current negotiations to expand its coverage.¹⁰ However, Cuba's approximation to the region has been gradually increasing since the mid-1990s, through CARICOM where the most recent steps taken were the signing of joint agreements for economic collaboration in tourism, transportation and trade.¹¹

Income level

In accordance with the classification of the World Bank, the majority of Caribbean countries are middle *income* (see appendix). Nine have above average per capita income levels relative to all middle income countries. Haiti is the only country in the low-income category (less than US \$ 755 per capita on an annual basis), while the only country classified as high income is Bahamas. This factor represents a relative advantage with respect to the global trend in the flows of financing, which have been found to be clearly adverse for low-income countries, whereas middle income countries have been favored by greater flows.

Cuba is among the countries of the lowest third within the low middle-income category, which would locate it in the risk area or of the lowest access to international flows. However, in practice this factor is not really the one, which determines greater or lesser Cuban access to investment flows. Others that are more critical include the high value of the country's risk,¹² the moratorium of payments since 1986 on the private foreign debt with the Paris Club, the low level of reserves¹³ (domestic saving), its exclusion from the IMF and the World Bank, and provisions

contained in US laws: the economic embargo and the Helms–Burton Bill, which veto or penalize almost any international financial transaction with Cuba worldwide.

Key Economic Sectors

With respect to economic activity in the Caribbean, the extraction of *primary products* has a relatively large significance, which constitutes a common feature with poor countries across all regions. The other relevant factors are *services* (tourism in almost all countries, financial services and transportation in a few). In Cuba, the overwhelming concentration of exports in primary products predominates as these represented 90% of total exports¹⁴ between 1994 and 1998, while tourism has experienced a significant expansion to the point of displacing sugar as the principal foreign currency income source since the mid-1990s. Likewise, there is a great similarity in the products and services exported by the region. Except for oil that is dominant in only some countries, all have the same export base: crops and their derivatives (sugar, fruits, tobacco, beverages, etc.), minerals, seafood, and services with tourism dominating. In recent years, there has been an acceleration of the percentage share of export-oriented manufactured goods, basically due to new provisions of market access to the US and Europe.

Economic Structure

The richer the Caribbean country, the greater is the proportion of the service sector in the gross national product. In the four richest countries, services are roughly two-thirds of the gross national product. In the rest of Caribbean countries, the proportion is higher than the average for developing countries. That is, *services have a determining influence on the level of economic activity. Their pattern of expansion points to the consolidation of a model based on the intensive use of labor and natural resources, rather than the expansion of the sector based on the utilization of knowledge, technologies, enhanced management techniques, as well as standards and procedures for quality control.*

Growth

The Caribbean's real growth performance between 1990 and 1995 was 2.1% per year, almost two percent below the average for Latin America (excluding the Caribbean). In 2001, a change in the pattern occurred due to the following factors:

- a) deceleration of world economic growth, especially of the US market, which reduced the rate of growth of world demand for exports that had been increasing steadily for over 10 years;
- b) fall in world prices for primary commodities and manufactured goods that are based on primary goods; and,
- c) characteristic difficulties for Caribbean economies that had to make numerous adjustments to be able to maintain moderate inflation rates.

Consequently, the volume of exports was reduced, basically due to the impact of the fall in sugar prices, and the instability of oil prices. Imports of goods surpassed the average for Latin America, increasing trade deficit pressures. After the events of September 11 in the US, the fall in tourism earnings caused by this event was not sufficient to compensate for the trade deficit in

most countries in the region. Between 1989 -1994 the Cuban economy contracted by -6.15% on average as a result of the crisis that followed the shock in foreign trade. This trend reversed between 1994 and 1999 when annual growth rates averaged 3.45%, a relatively high percentage for the Caribbean and for Latin America during the same period. However, it has been reduced to 1–2% per year during the last two years.

Trade Structures

In the economic and commercial integration process underway in the Caribbean, two basic patterns of incorporation can be identified. The first one is based on the formation of vertical flows for the production and export of manufactured goods destined primarily to the United States, basically comprised of textiles and components for the manufacture of several types of electric appliances and equipment. Although this trend is relatively higher in Central America and Mexico, there is a proportion of this trade that is distributed in the same way among countries in the Caribbean.

The second type of integration is one based on the merging of services, and involves several sectors and branches. Compared with the rest of Latin America, commercial services occupy a much greater proportion of total exports in the Caribbean, representing approximately one fourth of the income generated for all countries, regardless of profit levels. The share from manufactured earnings represents a much lesser share of GDP, although there has been a growing level of activity with respect to assembly for re-exporting in recent years. With respect to the change in the composition of exports, recent trends point toward a reduction of traditional crops and primary goods. For example: the exports of oil and coffee fell from representing 60% to only 15% in 15 years. As Table 1 indicates, this displacement has been over-compensated by the increase in the share of exports derived from manufactured goods, assembly production, services (tourism and financial), and nontraditional agricultural goods.

Table 1. CARICOM Distribution of Exports by category of technological intensity, 1999-2001
(% of total exports)

Primary Products	Manufacturing based on natural resources	Manufacturing based on poor technology products	Manufacturing based on intermediate technology products	Manufacturing based on high-technology products
30.8	37.9	8.1	14.1	1.1

Source: Economic Commission for Latin America and the Caribbean, United Nations, ECLAC. 2003. *Panorama de la inserción internacional de América Latina y el Caribe, 2001-2002*, Chapter IV, with data from COMTRADE.

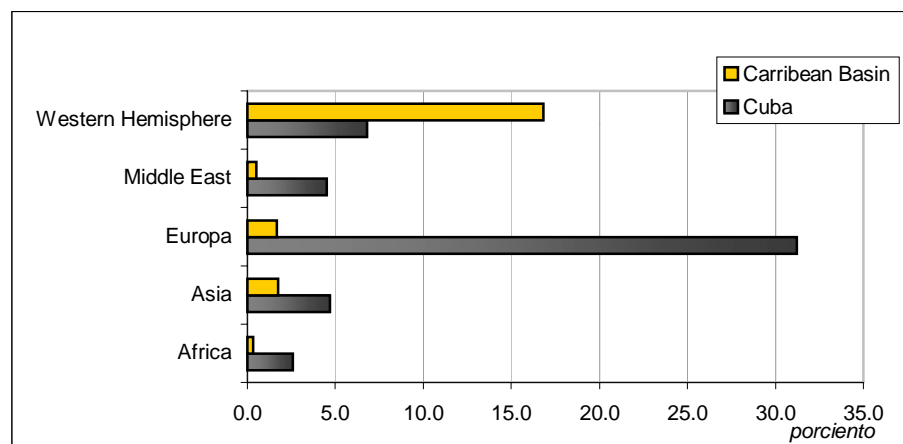
Intra and Inter-Regional Trade Patterns

Trade patterns with respect to trade within and with other regions determine a set of restrictions that are inherent to the Caribbean with respect to a trade strategy that seeks to promote insertion in world markets. As Figure 1 below illustrates, the principal trade partner for the region as a whole is with the Western Hemisphere and in particular with North America (the US and Canada acquire three fifths of the exports and supply almost half of imports of the Caribbean), followed by the European Union (a fifth of exports and supplier of a sixth of imports), while less than 3%

of exports are directed toward Latin America. The enormous concentration of Caribbean trade toward North America has fallen as a consequence of the loss of competitiveness that resulted from the entry of Mexico into NAFTA. The preferential access now enjoyed by Mexican exports has displaced several relatively more competitive regional exporters, significantly affecting the region's revenue share.

With respect to intra-regional trade, integrationist arrangements have helped increase trade to 21.4% of total trade in the Caribbean. However, this figure remains low. Historically, Cuba's trade with the Caribbean has been almost irrelevant (lower than 2%), and in addition, even still after the increase that was caused in recent years after the trade re-orientation that followed the collapse of the COMECON, the relative weight of the Caribbean in the Cuban balance of trade continues to be very low,¹⁵ averaging less than 4% between 1990 and 1999.

Figure 1. Caribbean Basin and Cuba: Trade with Other Regions in 1999



Source: Prepared by the author, with IMF Direction of Trade Statistics Yearbook 2000.

Limiting Factors for the Caribbean's Trade Strategy

One consequence of the small size of domestic markets and their limited export base results is the lack of domestically generated resources to carry out significant restructuring processes in the short-term. The concentration of exports in a small number of goods and services, which are chiefly primary products, *maquila* assembly, tourism and services, accentuates the region's vulnerability to changes in world markets. For example, *maquila* assembly exports depend entirely on unilateral preferential treatment granted by the US, a clause that can be modified at any moment for political reasons without consideration of local interests, which are irrelevant in comparison to US domestic interests.

In turn, the social costs derived from modifying trade policies (tariffs, exchange rates, etc.) have an immediate impact that is amplified by the very structure of the economies. Whereas the profits that trade reform could return to the region's principal trade partners, does not provide significant incentives to cause them to respond significantly in terms of trade volumes. This

characteristic implies a paradox: the road to modifying the pattern of economic development in alignment with the course of the most dynamic global trends implies growing liberalization of the trade regime and progressive transformation of the current distribution of exports from primary products toward manufactured goods and services. However, the very structure of Caribbean economies, with their strong concentration on the export of a few goods and concentrated market destination creates a very rigid framework for maneuver that severely restricts the possibilities for carrying out trade reform.

This creates “trade-offs.” On the one hand, there is pressure because if policy changes to restore export growth are not adopted at sufficient speed, the country will become further marginalized as trade blocs form –or in accessing to agreements with preferential regimes –which means that the opportunity to enter and be a part these accords will decrease. On the other hand, to accelerate beyond what is recommended in these processes has a strong likelihood of resulting in failure given the high vulnerability and limited available resources for adaptation.

Moderate levels of economic growth highly dependent on the European and North American markets also constrain the region. Given the similarity in exports, although intra-Caribbean trade has increased, it remains relatively small.¹⁶ This helps to consolidate a strong asymmetry of a historical character and without solution: trade with the Caribbean is of very little relative weight in the US trade balance, while *the US role in the region's external sector is decisive and tending to increase. Simultaneously, the European market is contracting and reducing or eliminating preferential treatments toward the region.*

The current trend of the growing displacement of traditional primary exports towards services and manufactured goods (assembly and textiles) is not derived from an increase in regional productivity, in negotiating capacity, nor in the increased flexibility of tariff regimes, but rather the characteristic need to accommodate to investment and trade flows that come from the US market in light of increases in European and Asian competition in Latin America (Gunn, 1997). Manufacturing constitutes one of the sectors of greatest dynamism in the general process of the region's restitution of exports, and within these, textiles have been one of the categories that have obtained better conditions of access toward the US market for some time. However, in relative terms, this sector does not represent a key sector with respect to the US's trade balance. In this realm, the most recent initiative, the US Act of Trade and Development for the Caribbean, known as TDA2000 (or also know as the U.S. - Caribbean Basin Trade Partnership Act of 2000 (CBTPA)) constitutes an illustrative example in this regard.

III. Role of Trade in Development Strategy

There is an important difference that defines the role the external sector plays within a general development strategy. A development strategy constituted in an environment where foreign trade is the principal focus is not the same as one in which the external sector is one of many elements and does not represent a priority that determines the rest of the interrelationships within the economy. Cuba and the other countries in the Caribbean all share the same feature—the external sector is not one within several factors, but the vital axis for economic activity. To a greater or lesser extent, all the countries of the Caribbean Basin are small economies with respect to international markets, incredibly open given the limited diversity of domestic outputs in order to

be able to meet a significant proportion of their needs. To this end, they simply cannot reach rates of sustainable economic growth without externally financed support and provisions for market access.

Free Trade, Market Power and the Best Option for the Caribbean: Unilateral Liberalization or Collective Agreement?

A characteristic of special importance with respect to the capacity of the Caribbean economies to implement a strategic agenda in the area of trade policy is associated with the small relative size of its combined market with regard to that of its principal partner, the United States. In formal terms, under “classical” assumptions conventional theory tends to identify as a “better option” the movement from more or less protected markets by tariffs toward free trade. This seems to be the most frequent recommendation in light of results derived from an important part of the studies carried out from different perspectives.¹⁷ Even in those cases in which opposed results were experienced, it is argued that the results are not conclusive, or at least not sufficiently strong so as to rule out that trade liberalization should nevertheless still be undertaken in view of still unconfirmed assumptions. Accordingly, the removal of trade barriers is at least a matter of “equal benefits with lower costs for all parties” in which national interests and the relative power of economies do not influence the most efficient assignment carried out from and for the market.

Nevertheless, despite substantial tariff reductions in almost all countries in recent years, the world of today is still characterized by the predominance of tariffs of one or another type. It is significant that incentives still exist for large countries in particular, with technological endowments, human and natural resources, to maintain tariffs, contravening the precept that free trade brings a Pareto efficient distribution where all benefit. The explanation for this situation partly has to do with the capacity of a country to be able to influence prices, or what is called the effect of country “size”, and how this is expressed in practice with respect to tariff policy.

Small countries (price takers) do not have any influence on world market prices. Sufficiently large countries, on the other hand, find themselves in a similar situation to that of a monopoly, being able to select the volume of export production to the degree that it influences world market prices and thus maintain production levels in order to maximize profits. Trade theory has proven that under traditional assumptions, there exists an optimal tariff that can improve the trade conditions of a large country, though this has parallel effects that distort production and consumption, “because the profits from an improvement in the terms of trade through tariffs exceed the losses due to distortions” (Chichilnisky 1995 and Krugman and Obsfeld 1998). This finding of one country over others naturally raises the counterpoint that in response, others may also seek a “strategic” maximization of tariffs resulting in a scenario of interactions that conclude with a “balance of optimal tariffs.” This already differs in practice from the balance achieved by the free market whereby some countries are better than others in view of their capacity to influence prices based on their greater economic size (Kennan and Riezman 1988 and Kennan and Riezman 1990). This is nothing else but the “rational” response to maximize via the economic incentives of “market power” instead of Pareto type optimization.

The same argument can be extended with respect to interactions between regional commercial blocs. The creation of free trade areas renders greater market share for agreement members who

can utilize their collective strength to impose or maintain higher tariffs than those that apply within member countries to nonmember countries. Accordingly, although economic theory posits the desirability of moving economies in the direction of trade liberalization, in practice the most advisable strategy for smaller countries is not to liberalize “on their own” without first “harmonizing” themselves purposely toward regional options for free trade zones.

Despite various efforts aimed at consensus building, the real outcomes for Caribbean countries have progressed in the opposite direction. The composition of current tariffs demonstrates that these have been shaped on the basis of a process of historical accumulation of policies taken at different times for dissimilar reasons. Each country has adopted tariffs and quantitative restrictions to specifically respond to particular circumstances or in order to “protect” or respond to the interests of specific domestic groups, which indicates that an attempt has not been undertaken to identify the “social” returns based on comparative advantages or of potential comparative advantages.¹⁸

As a consequence of the utilization of discretionary and non-tariff restrictions, social costs have increased and with these the pressures on the appreciation of the exchange rate, which in turn further hinders movements aimed at liberalizing trade and reducing the power of domestic agents who benefit from restrictions that generate artificial profits. In the end, regardless of whether domestic pressures to maintain a certain level of tariff protection or limit market access are justified, it is a fact that the low relative weight of Caribbean economies gives them little to almost no capacity to influence on the decision-making processes with respect to trade both at the international level and in its principal market, the United States.

Access to the US Market

The trade relations of the Caribbean with the United States have two fundamental axes: the Caribbean Basin Initiative and the United States- Caribbean Basin Trade Partnership Act as a part of the Trade and Development Act of 2000 (TDA2000).

The policies and trade practices of the US toward Latin America have been modified becoming more complex with regard to the instruments and the means for guaranteeing both greater effective access for the Latin American exports and a more diversified protection for US producers who could be affected by these same measures. Among others, the following should be noted:

- Promotion of agricultural US exports via financing for exporters in terms of research and development, openness of markets, development of trademarks and credit guarantees for imports;
- Antidumping and countervailing duties (particularly in case of key outputs for the region, such as food, minerals and chemical products);
- Preferential access granted on the basis of bilateral or multilateral agreements;

- Application of quotas (especially sugar, which turns out to be particularly restricted due to the interests of US corn producers); and,
- Tariff escalation: to the extent that the exports begin to adhere greater preparation— what confers them greater added value—then they increase notably the applicable tariffs.

By way of example, credit guarantees for exports are covered under the new Law of Agricultural Security and Rural Investment administered through the US Department of Agriculture that grants credits of six months to three years (GSM-102), and from three to ten years (GSM-103). Moreover, the Commodity Credit Corporation (CCC) for agricultural products can cover up to 98% of the principal and part of the interests of the credits granted by US financial institutions to select foreign banks, that in turn issue bills of credit for importers of US products.

Financing

An important part of the expansion of trade is determined by access to financing. In case of the United States, there exists a network of government-affiliated institutions that traditionally have had a role in the support and promotion of trade, particularly in the case of Caribbean countries. These are synthetically:

- FCIA, Foreign Credit Insurance Association—insurance for US exporters against commercial and political risks.
- Eximbank, the Export-Import Bank of the United States—export financing through direct loans, intermediate loans for third parties (banks or companies), insurance and guarantees for purchases of goods produced in the U.S bound for export.
- CCC, Commodity Credit Corporation—financial services for goods of an agricultural origin.
- OPIC, Overseas Private Investment Corporation—a self-financing federal corporation aimed to assist U.S. investors in developing countries and emerging economies through project financing, investment insurance and investor services.
- USAID, US Agency for International Development—assistance programs and development projects through economic support funds, special assistance initiatives and development assistance for small development projects (apart from economic policy and structural adjustment programs).
- SBA, Small Business Administration—Counsel, protection and support for US business with information and special services for small exporters, such as its Export Legal Assistance Network and its International Trade Loan Program that guarantees up to 85% of loans up to \$1 million for business that meet its size requirements.

- TDA, US Trade and Development Agency—funds various forms of technical assistance, feasibility studies, training, orientation visits and business workshops that support the development of a modern infrastructure and a fair and open trading environment.

The TDA is particularly relevant for this study as it is the agency that has served as the point agency for the most recent political commercial initiative for the Caribbean— United States-Caribbean Basin Trade Partnership Act in 2000.¹⁹ The TDA (CBTPA) represents a shift in the strategy promoting economic approximation with the Caribbean. In practice, the negotiation model based on “fast track”, which was rejected on several occasions by Congress, has been replaced with the “NAFTA Parity Bill”, a regimen oriented toward specific commercial initiatives that assumes a selective and step-wise treatment across time. On the one hand, this increases the tendency toward the conditionality of US assistance toward these countries; while on the other hand, it facilitates the Congressional approval process. This is the first time in 10 years that the US Congress approves a trade policy not under a “fast-track” scheme and the first trade legislation approved in six years.

Tariffs

The principal characteristic of the tariff systems between Latin America and the United States is the difference in systems and methods. In Latin America, and ad valorem system of the FOB value at the point of export is utilized, while the structure is much more heterogeneous in the United States and the European Union and includes:

- Specific tariffs (by unit of weight, volume, number of parts, and seasons).
- Tariff quotas (quantitative restrictions)
- Special regimes

Policies and business practices are another facet of the problem. In several instances, these have proven to have an impact greater than tariffs, which on average tend to be short-term and having a tendency to decrease over time. In 2001, CARICOM countries had tariff-free access to the US market for 72.7% of the total goods, if the applied ad valorem duties are taken as a reference. However, a more detailed examination reveals that for those products that constitute the true sources of income (food, manufactured goods, such as textile, footwear, leather, tobacco, chemicals, and sugar), tariffs are levied well above the average. In other words, there is a high dispersion in the US tariff structure; the standard deviation is greater than the average at more than two and one-half times. For example, there are specific and composed tariffs (for chemical products, textiles and sugar) and in the case of tobacco the value paid (ad valorem) is 350%.

Table 2. Ad valorem Duties: Applied by the US to CARICOM Imports (billions of US\$)

Duties Total Value	Taxable Value	Perceived Duties	% Duty-Free	Taxable Equivalent Ad Valorem	Equivalent Ad Valorem Total
3899	1065	15	72.7	1.4%	0.4%

Source: Economic Commission for Latin America and the Caribbean, United Nations, ECLAC. 2003. *Panorama de la inserción internacional de América Latina y el Caribe, 2001-2002*, Chapter IV, Table IV.I pg.3.

Table 3. U.S. Tariff Structure (in percentages)

Indicators	1996	1998 ^b	1999 ^b	2000
Simple average tariff ^a	6.4	5.9	5.7	5.4
Agricultural products (WTO definition) ^b	10.0	10.3	10.7	10.4
Non-agricultural products (WTO definition)	5.7	5.0	4.7	4.5
Items with tariffs above 15% (as a percentage of the total)	8.9	7.7	7.4	7.0
Standard deviation	13.4	12.9	13.3	13.1
Variation coefficient	2.10	2.19	2.34	2.38

Source: World Trade Organization (WTO). 2001. "Examen de las Políticas Comerciales-Estados Unidos." WT/PR/S/88. Geneva: WTO, p.31.

^a Contingent tariffs are excluded.

^b Includes Chapters 1 -24, except fisheries and fish products, and the SA 2905.43, 2905.4, 3809.10 and 3823.60 sections, as well as other categories covered in SA 33.01, 35.01-35.05, 41.01- 41.03, 43.01, 50.01-50.03, 51.01-51.03, 52.01-52.03, 53.01 and 53.02.

Fiscal aspects, role of the tariffs in terms of income

The high relative weight of fiscal revenues derived from tariffs is essential for Caribbean economies. This factor creates an important limitation both from the standpoint of macroeconomic policy and the commercial side. As is observed in Table 4, despite the trend at decreasing, these continue to be a source of income without a short-term substitute for some countries.

Table 4. CARICOM and Cuba: Participation of Taxes on Trade and International Transactions as a share of Fiscal Revenues in 1996

Country	Percentage
Anguilla	77.00
Antigua and Barbuda	66.10
Dutch Antilles	39.16
Bahamas	59.98
Barbados	8.60
Belize	52.39
Dominica	56.50
Granada	16.77
Cayman Islands	42.16
Jamaica	14.00
Montserrat	52.50
Dominican Republic	44.80
Saint Lucia	58.70
St. Vincent and Grenadines	40.80
St. Kitts y Nevis	55.20
Suriname	41.70
Trinidad and Tobago	10.40
<i>Cuba*</i>	1.85

Sources: All data except Cuba is from ECLAC (1999) *Panorama de la inserción internacional de América Latina y el Caribe*, Table VI.1, p.128. Data for Cuba was prepared by the author on the basis of data from the Statistical Yearbook, ONE 1999, p.96.

Table 5. Cuba: Income from Tariffs

Year	GDP in Current Prices (MMP)	Income from Tariff (MMP)	Percentage
1995	21737.1	269.4	1.24
1996	22814.7	423.2	1.85
1997	22951.8	351.2	1.53
1998	23900.8	385.6	1.61
1999	25503.6	409.9	1.61

Sources: Calculations based on National Statistics Office, ONE, Statistical Yearbook 1999, p.96.

Table 6. Cuba: Annual Average Tariff (*percent*)

Year	Average Tariff
1989	0.700
1990	0.515
1991	0.340
1992	0.238
1993	0.238
1994	0.238
1995	0.238
1996	0.238
1997	0.107
1998	0.107
1999	0.107

Source: Estimates of the author based on interviews with experts.

IV. Competitiveness and the Regional Framework

Traditional Comparative Advantages and Economies of Scale

Latin American exports have evolved generally toward growing dynamism in several exports in recent years due to the benefits of agreements of integration or free bilateral and multilateral trade. However, a significant part of that evolution is the result of the Mexican-side of the North American Free Trade Agreement (NAFTA) and the strengthening of trade within MERCOSUR and the Central American Common Market. In that overall export evolution process, the Caribbean has scarcely participated. In fact, recent studies show that there has been a concentration toward few exports whose growth rates have only increased as a consequence of the progressive application of the TDA2000, and not as a result of insertion of more dynamic international production chains.

The composition of Caribbean exports shows that despite changes in recent years towards exports with greater technological content, most are still primary commodities and manufactures based on natural resources, with low degree of “technological intensity” compared to the average for Latin America as is shown in Table 7 below.

Table 7. Export Structure by Category of Technological Intensity 1999-2001^a (*as a share of total exports*)

Regions	Primary Products	Natural Resource Based Primary Products	Manufactured Goods With Low Levels Of Technology	Manufactured Goods With Intermediate Levels Of Technology	Manufactured Goods With High Levels Of Technology
Latin America and the Caribbean	27.3	17.5	12.2	26.1	16.9
CARICOM ^b	38.8	37.9	8.1	14.1	1.1

Source: Economic Commission for Latin America and the Caribbean, United Nations, ECLAC. 2003. *Panorama de la inserción internacional de América Latina y el Caribe, 2001-2002*. Table III.1, pg.4. based on COMTRADE data.

^a Some of the totals exclude some groups—351, 883, 892, 896, 911, 931, 941, 961 y 971— as these pertained to special categories.

^b The average between 1999-2001 roughly corresponds to the information for 1998-2000.

In this panorama, Cuba constitutes a separate case. As Table 8 indicates, despite the strong geographical reorientation of foreign trade that followed the collapse of the Socialist Bloc, the structural composition of its trade portfolio remains dominated by primary products with a very low level of participation of other exports of greater technology or human capital content. Contradictorily, the displacement toward tourism as a primary source of income has not but transferred the structural problem from sugar to services because essentially this type of insertion does not take advantage of the already accumulated labor resources that have accrued from years of investment in education and professional training. This trait, together with an appropriate infrastructure, “potentially” could permit the retrofitting of industries towards the production of manufactured goods and electric appliances bound for export assuming that at least one level of equivalent access to that of the region to the US market could be achieved, with relatively minimal costs.

Table 8. Cuba Exports: Dynamics and Composition

Product Group	Value 1998 (in millions USD)	% Growth 1994-98	% of Exports
Primary Products	1181	0	90
Manufactured Goods			
Intensive in:			
- Natural resources	61	26	5
- Labor	5	4	0
- Technology	31	-26	2
- Human Capital	20	5	2

Source: WTO International Trade Commission - ITC 2001. Calculations based on statistics of COMTRADE. For further detail see, <http://www.intracen.org/countries/htm99/cub.htm>

Competitiveness of Cuba within the CARICOM Framework

Several products and services are likely to be exported successfully by US companies in joint ventures as exemplified by the Central American market, once Cuba is able to participate in an equal playing field. This change could be associated with an important jump in the use of technologies and quality improvements. Such is the case of services in computer technologies,

communications, materials, and services for the construction industries, tourism, air and maritime transport, products and techniques for agricultural application, to cite a few examples. It will be necessary to delve further into the evaluation of these alternatives with more precision, but as first approximation, the options of insertion in the regional market based on the trade-offs in competitiveness should be identified in order to effectively orient future studies. The selection of "indicator areas" presented below does not constitute in itself a "definitive" criterion for valuation, at the most a minimum comparative reference, prepared with aspects that are most frequently taken into account for agreements of this type and summarized in Table 8.²⁰

- *Availability and the cost of capital.* In this case, Cuba is severely restricted, with a high country risk, without membership in the principal international finance institutions, with a low level of foreign currency reserves, with a high level of external debt depending on negotiations and pressures from the North American blockade. In this aspect, Cuba should be qualified below the country average in the region with respect to access to credit.
- *Government regulation.* Despite having reformed the system of state monopoly on foreign trade, there still exists a strong level of trade regulation in Cuba compared with that of its neighbors. This represents an advantage with regard to the mobilization of limited resources when a disadvantage concerns prioritized projects, but on the other hand, constitutes a disadvantage for those companies not ranked among its priorities, as well as for middle and small businesses.
- *Skilled labor.* The general and professional levels of education in Cuba guarantee a high flexibility with respect to the assimilation of technology and advancing of productive procedures.
- *Macroeconomic and Fiscal Policy.* Institutional and regulatory reform has been undertaken with caution and gradualism in the Cuban economy. Although numerous structural problems pending solutions persist, the government has been consistent with the adjustment strategies undertaken. In general, international observers generally accept the valuation that it is not worth expecting drastic changes in the medium term.²¹
- *Marketing.* If a few products whose identity, brand names, or exclusive character does not make them representative (tobacco, rum, nickel and some intellectual property rights) are excluded, marketing activity in Cuba is not comparable with the average levels in the CARICOM. This is also influenced by the fact that an important part of the region's marketing services are imports or benefits of first level international agencies in the United States, United Kingdom, etc.
- *Design and quality of exportable goods.* There have been important advances in Cuban industries in the last three years, especially with respect to what has become «exports within the borders» or outputs destined for the domestic market in foreign exchange. However, on average, these are still below the levels of presentation and regional quality, although great varieties of outputs in tourism (and a few services) have had a notable spring in their standard of quality.
- *Productivity.* There has been a slow recovery of Cuba's productivity rate, but this is still insufficient to sustain a rate that is of sufficiently strong to compensate for other adverse factors

so as to bring economic recovery. If only outputs linked to exports, the average indicator is above average, but the value of this assessment is questionable because the calculations of labor costs are made on the basis of an overvalued exchange rate.

- *Quality of administration and control.* Strong pressure to achieve reliable accounting systems in the companies by central Cuban economic management agencies remains, even in those sectors linked and ranked among the highest in terms of foreign exchange income, this indicator is considered below average, largely a result of the absence of a control system that includes bankruptcy and a market for domestic financial claims –an indispensable prerequisite is still in the midst of an uncompleted merging process.
- *Natural resource endowments.* In this regard, Cuba has a very favorable situation. In addition, it has advantages of scale, since it far surpasses resources in broad proportions in terms of volumes compared with other countries in the CARICOM (for example, tourism, sugar, nickel mining, fishing, citrus fruits etc).
- *Technology (Industrial Factories).* This element was classified as moderate, because although in some branches high levels of technological obsolescence exist, an important level of reserves in terms of productive capacity that can be exploited in very little time with minimal investments for its resuscitation exists. As a result of investments undertaken in previous decades that maintained a configuration characterized by "low efficiency and an abundance of resources to be invested",²² many industries use technologies that are respectively high consumers of energy, contaminants and in general scarcely efficient given current requirements. However, the situation is complex to diagnose as together with these obsolete plants, another generation of new investments have been incorporating state-of-the-art technologies that are highly competitive, precisely in the sectors linked with electric generation, oil and gas extraction, services, and exports, that are those which have greater weight in this analysis.
- *Tax structure (tariffs and non-tariff barriers).* Although Cuban tariffs by the standard of origin are lower than those in the Caribbean, structural barriers, such as the lack of access to the domestic market and bureaucratic controls, exist that are a constant subject in discussions among businessmen and representatives in the area.²³ Mechanisms of consultation with and aim of creating more expeditious approval procedures for the approval of product lists, facilitation of transactions etc, are being promoted. However, in practice, there are additional procedures that make the insertion in the world market complex. This factor was classified as below average in the meantime as it is not compatible with Caribbean levels.
- *Transportation infrastructure.* Cuba has above average infrastructure in terms of its communication, roads, ports, and airports networks, although the sector requires significant investments in order to modernize its services to satisfactory operational levels. Relative to the scale in the CARICOM, the country has a fairly significant aviation fleet, as well as maritime container services that operate separately or in association with contractors.
- *Salaries.* The compensation systems in export-linked industries do not resemble the remaining procedures in this area. Although wage stimulation mechanisms have permitted notable increases in productivity in some outputs, this problem is often cited for the effect it has

in generating incentives toward the double payment of the work force in resident companies in Cuba. This indicator is classified as below average.

Table 9. Cuba's Sources of Relative Comparative Advantages in Comparison with Caricom (*a proposal for subjective estimation*)

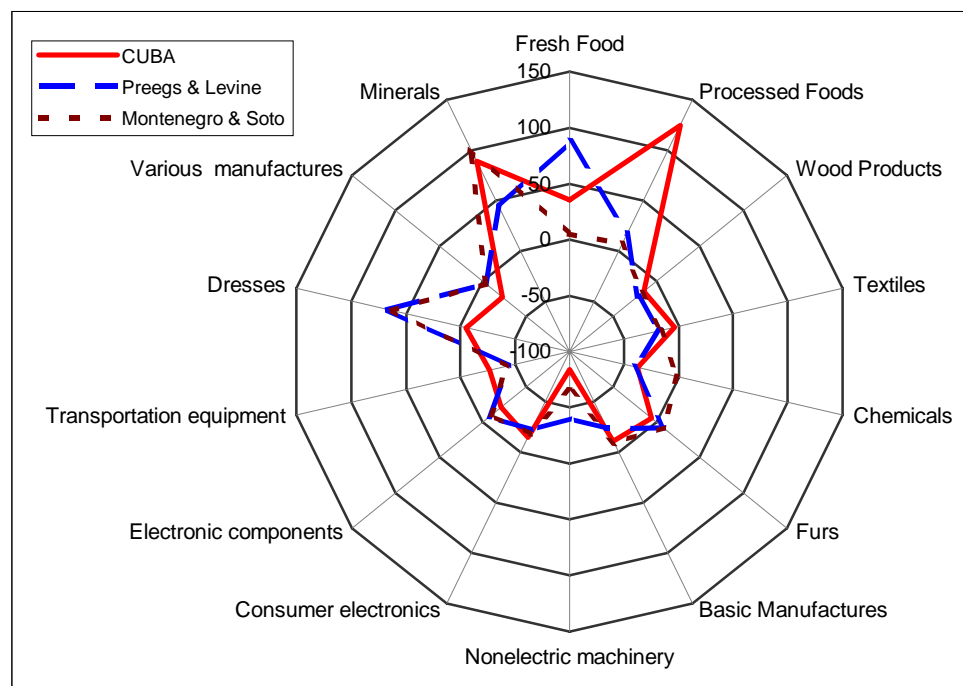
<i>Source</i>	<i>Valuation</i>
Availability and the cost of capital	<i>Insufficient</i>
Government regulation	<i>Above-Average</i>
Skilled labor	<i>Above-Average</i>
Macroeconomic and fiscal policy	<i>Moderate</i>
Marketing	<i>Insufficient</i>
Design and quality of exportable goods	<i>Below Average</i>
Productivity	<i>Below Average</i>
Quality of administration and control	<i>Insufficient</i>
Natural resource endowments	<i>Above average</i>
Tax structure (tariffs and non-tariff barriers)	<i>Below Average</i>
Technology (industrial factories)	<i>Moderate</i>
Transportation infrastructure	<i>Above average</i>
Salaries	<i>Below average</i>

Source: Elaborated by the author based on consultation with experts. The level is classified with reference to CARICOM standards. The scale has been created with the following values: above-average, moderate (equal to the regional average), below average and insufficient.

Cuba: Revealed Comparative Advantages

From a standard perspective, the evaluation of revealed comparative advantages of export-oriented production for Cuba offers some elements of interest. In the trade simulations carried out, as well as terms of real performance, Cuba's external sector is oriented toward a structure that consists of a high relative proportion of goods including fresh food (real), dresses, minerals, and processed food (in the simulations). In the real case, this is due to the high share of sugar as a proportion of total exports of goods (around 90%). This is confirmed in the two simulations²⁴ by Preeg and Levine (1993) and Montenegro and Soto (1996) due to the presence of exports of textiles, processed foods and mining products in a different proportion in the proxy countries used in view of their access to the US market.

Figure 2. Revealed Comparative Advantages for Cuba in actual versus two “Proxy” Versions



Source: Prepared by the author with data from the WTO-ITC based on proxies obtained from Preeg and Levine (1993) and Montenegro and Soto (1996).

Trade with the US: A Gravity Model Simulation and its results

A common and widely accepted technique to estimate potential trade volumes between countries or trade blocs is the Gravity Model,²⁵ whose name alludes to the principles embodied by the law of physics with the same name. It is based on the premise that trade flows between countries are determined by two opposing forces—the overall level of economic activity and income levels that are comprised by the export and import demand potential and the obstacles to trade including transport costs due to distance, trade policies and cultural differences. The combination of both forces have proven to be reliable predictors in empirical estimates of trade (Havrylyshin and Pritchett (1991), Frankel and Wei (1993), Bayoumi and Eichengreen (1995) and are widely used by the World Trade Organization.²⁶ The theoretical foundations for the gravity model were developed by Bergstrand (1989) and Helpman & Krugman (1985). In essence, the method consists of identifying a pattern of trade for a specific geographic area or group of countries based on real flows of trade. Based on estimates obtained from standardized parameters, expected values of commerce are estimated for the countries under study. The contrast between real commercial values and those obtained by simulations allows one to identify if the country is above or below its expected value.

In the case of potential trade between Cuba and the United States, the trade simulations that have been performed to date have utilized three approaches. First, the identification of the trade volumes expected by sectors and in aggregate terms based on restricted foreign currency resources and a conventional trade model (USITC 2001). Second, an estimate that attempts to adjust for the level of distortion in Cuban trade with respect to trade between other countries in

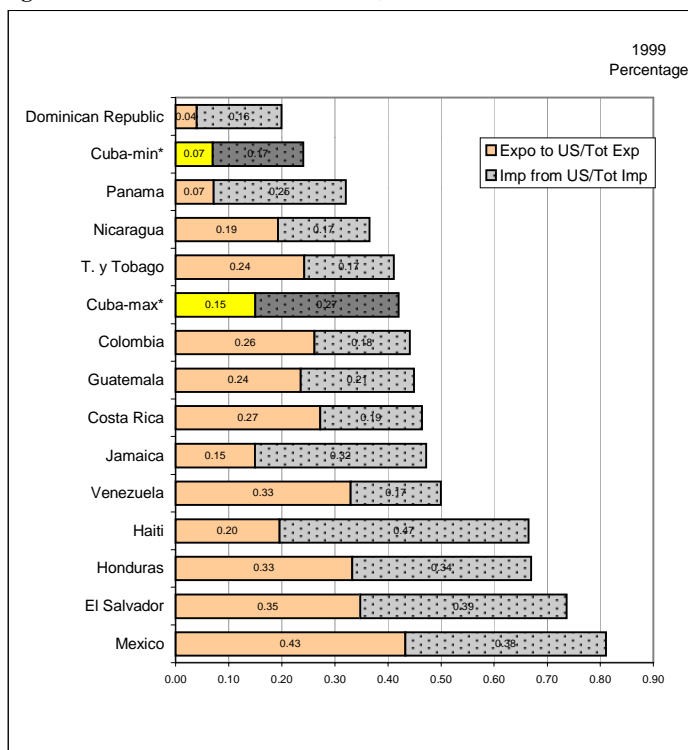
the Caribbean and the United States (Montenegro & Soto 1996). And finally, those that attempt to factor the impact of possible participation in differing trade integration schemes with Latin America and its possible impact on bilateral trade between Cuba and the US (Selva 1997).

In this section of the chapter, the results of a gravity simulation model are presented. The purpose of these estimates is twofold. First, to verify whether there were significant changes with respect to previous estimates, given that significant trade re-orientations have taken place in the short term during the latter part of the 1990s and the notable increase in market volatility with Cuba's trade partners. Secondly, to establish how income level in aggregate and per capita terms impact trade flow stimulations. The results that are presented in Table 10 were obtained from the application of a conventional gravity model for a first sample of 65 countries as "reporter" and 100 countries as "partner" from which was derived an "aggregate" model. A second version of the model was run limiting the "reporter" countries to the 13 members of the CARICOM and this is called "Caribbean Basin" following the approach taken by Montenegro and Soto (1996). The data utilized for 1997 was taken from IMF's Direction of Trade Statistics. Three variants from the simulations are presented in Table 10. The first variant includes all the variables. The second attempts to quantify the impact of the Heckscher-Olin effect, that is, to measure to what extent the level of income (economic activity) of each country could affect potential trade. The third variant excludes per capita income in order to control for the probable distortion that stems from the increase of the presence of high flows of income reported by Caribbean countries whose economies have an important share of financial service operations.

What is interesting from this exercise is that in the final version, the sign of the coefficient for per capita income (GDPPC) has a smaller variability in magnitude between the global version and the version estimated for the Caribbean Basin. Concerning the coefficient for the NAFTA variable, there is an increase in the value associated with this coefficient when the estimate was run for countries in the Caribbean in the third variant. This is due to the fact that the relative effect of the increase in trade in case of Mexico (being a part of NAFTA) is much greater if it is compared with the Caribbean than that which is estimated from the group of 65 countries in the "general" sample. The initial results of Montenegro and Soto (1996) were confirmed, though on this occasion greater precision is given to the role of regional factors in the configuration of trade flows. Finally, a value of US-Cuba trade in the first year equivalent to some US\$ 2,602 000 million was estimated, which locates the projection well within the range already obtained by previous studies (Montenegro and Soto 1996, Selva 1997 and USITC 2001), with different methodologies, but quite convergent assumptions.

Table 10. Trade: Estimate obtained by applying a Gravity Model a) Global (65x100 countries) b) Caribbean Basin (13x100 countries)

1997 (Method: TOBIT Canonic)	Model I				Model II: Heckscher-Olin Effect				Model III: Final Version			
	Global		Caribbean Basin		Global		Caribbean Basin		Global		Caribbean Basin	
	Coefficient	Z-statistic	Coefficient	Z-statistic	Coefficient	Z-statistic	Coefficient	Z-statistic	Coefficient	Z-statistic	Coefficient	Z-statistic
<i>Intercept</i>	4.187409	11.63209	5.654618	4.553174	5.030874	15.32729	5.038719	4.824124	4.235649	11.82535	4.772360	3.878782
<i>GDP</i>	0.719968	50.85403	0.415529	10.44909	0.758913	61.18631	0.395658	11.87072	0.720832	50.93661	0.413681	10.30745
<i>GDPPC</i>	0.114657	5.582700	-0.057694	-0.915246	0.043963	2.749837	0.189535	4.035797	0.097450	6.045999	0.089807	1.816542
<i>Dij:GDPPC</i>	-0.026126	-1.289274	0.224328	3.713893	0.043963	2.749837	0.189535	4.035797				
<i>Distance</i>	-0.918100	-24.53333	-0.704393	-6.429134	-0.914159	-24.32121	-0.689288	-6.359562	-0.919222	-24.58001	-0.655242	-5.969830
<i>Border</i>	0.827969	5.818587	0.586240	1.237126	0.834103	5.835182	0.598155	1.261853	0.847418	5.986018	0.531995	1.112846
<i>Language</i>	0.561968	7.583898	0.086761	0.432404	0.603140	8.142398	0.074593	0.372314	0.573194	7.781440	-0.037030	-0.185422
<i>Island</i>	0.097365	1.749645	0.767849	5.457189	0.116533	2.088507	0.759981	5.407420	0.097438	1.750701	0.766969	5.400065
<i>NAFTA</i>	-0.093176	-0.089285	1.676650	1.188194	-0.149693	-0.142800	1.712559	1.213256	-0.112334	-0.107631	1.875047	1.317526
<i>CARICOM</i>	0.249875	0.863996	0.140437	0.315279	0.391852	1.354258	0.128499	0.288393	0.264478	0.914831	0.192386	0.428135
<i>APEC</i>	1.573202	11.56779	0.767400	1.450426	1.624995	11.92268	0.778339	1.470432	1.587487	11.70884	0.631386	1.185212
<i>ANDEAN</i>	0.446351	1.196250	0.447886	0.655847	0.515745	1.376753	0.459531	0.672541	0.465657	1.248713	0.375855	0.545528
<i>CACM</i>	1.062420	3.108029	0.081501	0.154640	1.148548	3.348190	0.109358	0.207694	1.062378	3.107344	0.267134	0.504449
<i>R-adjusted</i>	0.650223		0.317059		0.646067		0.317010		0.649100		0.303306	

Figure 3. Cuba and the Caribbean Basin, Trade with the US

Source: Results obtained by the author applying gravity models described above, but in separated versions for exports and imports based on data from IMF Direction of Trade Statistics Yearbook (2000).

V. Conclusions

For the Caribbean as a whole, the strategic *limitations of integration and commercial policy* are due to the following factors:

- As the size of economies is small, “market power” is weak and there is reduced level of influence in terms of volumes and prices in world trade (Price and quota takers).
- Intraregional trade is insignificant, as is the level of macroeconomic convergence (international reserves, exchange and fiscal stability) due to internal asymmetries.
- The industrial structure is minimally diversified and is highly dependent on foreign trade and preferential market access mechanisms.
- Exports are concentrated in “less dynamic” products with regard to the international flows (primary products—mining and food, as well as manufactures with limited technological applications—textiles and dresses) resulting from

“adaptive” processes and not “proactive policies” of incorporation into international investment and trade chains.

- The *structural pattern of integration into international trade* is based on mixed schemes: a) “vertical” flows of manufactures, and b) services (tourism, financial, transportation), from goods intensive in the use of labor and natural resources. There is limited incorporation of technology and knowledge, in particular in the area of information technologies and communications that constitute a decisive factor in the merger of institutional frameworks, commercial practices and more effective policies.
- High dependency of fiscal revenues derived from tariffs.
- Although significant share of exports do not pay tariffs in the US market (72% in 2001), there is a strong vulnerability with respect to principal exports (food, textiles, minerals, tobacco) at restrictive treatment from the US by means of specific tariffs, special regimes, policies of progressive, scaled-up tariffs and quotas.

This set of elements results in a *scenario of “continuity” in the medium term* (2 to 4 years). It is expected that principal efforts are oriented toward a combination of attempts aimed at preserving the preferential treatment that has been achieved to date (primary products—mining and food—), together with a parallel effort to diversify and expand the growth of services (tourism) and manufactures of low technological complexity (textiles, assembly of electric appliances).

Despite commonalities with regard to productive structure, exports, and macroeconomic limitations, there is more differentiation than convergence with respect to Cuba's trajectory. The most important is the lack of access to the US market, which explains the current, totally different geographic trade pattern. Based on the estimates carried out using the gravitational model, trade with the United States in either of the two versions of the model presented, (one derived from a general scheme, the second on a Caribbean scale), the expected maximum and minimum volumes *do not represent an important short-term increase in Cuba's current trade*. This result implies that the “diversion” of trade instead of the “creation” effect will predominate in the near term. According to this estimation, Cuba would be below the Caribbean median or near the minimum level by current regional standards.

In a scenario of steady increase in trade between Cuba and the United States, assuming the absence of special financing flows different from the regional average as well as the lack of preferential access similar to that enjoyed by its principal potential competitors in the Caribbean that have resulted from bilateral or multilateral treaties of long standing, *the estimated potential of Cuban exports and imports does not change substantially the current pattern of dependency of the trade balance — a relatively high share of domestic absorption and the continuing need for short-term credits with high interest rates*. Accordingly in the case of Cuba, in contrast with the rest of the region neither of the following conditions should be expected to materialize from trade expansion under established assumptions: 1) a structural change in foreign trade; 2) a change in the dependency of the rate of current Cuban economic growth on access to external financing; nor, 3) a change in the dominant role of domestic absorption in sustaining the most dynamic Cuban industries. Thus, the current core differences with regard to geographical environment should persist.

Appendix
 Size of the Economies in the Americas by Income Level

Classification 2000/ 2001		
Low		Haiti
Middle	Low	Belize Bolivia Colombia Costa Rica Cuba Dominican Rep. Ecuador El Salvador Guatemala Guyana Honduras Jamaica Paraguay Peru St. Vincent and Grenadines Suriname
	High	Antigua and Barbuda Argentina Barbados Brazil Chile Dominica Granada Mexico Panama Puerto Rico St. Kitts and Nevis St. Lucia Trinidad and Tobago Uruguay Venezuela
High	OECD	Canada United States
	Non-OECD	Aruba Bahamas Bermuda Is. Cayman Dutch Antilles Virgin Islands

Source: World Bank, *World Development Report 2000-2001*

¹ The arguments presented on this subject are taken for the most part from Edwards (1997), Francois, Nordström & Shiells (1996), Michalopoulos (1999), Anderson & Neary (2000), IMF & World Bank (2001). An exhaustive review of the literature in this regard is referred in Edwards (1993) Rodrik (1995), IMF (2001).

² The nature that trade policy itself, which is carried out by several instruments including tariffs, quotas, licenses, exchange rate controls, etc., as Edwards (1997) explains, “suggests that attempts to construct a single indicator of trade orientation may be futile, and will tend to generate disagreements and controversies”

³ A country can substantially alter its trade and continue to be highly dependent on it.

⁴ Some of the most interesting are: Corden (1966), Anderson and Neary (1994), Pritchett and Sethi (1994) (Levine and Renelt 1992), Leamer (1988), Wolf (1993) and particularly the one of Easterly (1993) who analyzing a sample of 57 countries using a similar index of price distortion to that of Dollar, confirm the existence of a negative relationship between price deviations and growth. The theoretical model utilized showed how distortions of relative prices caused by commercial policy had notable effects on growth as a result of distorting investment decisions.

⁵ The fundamental results were in the direction of confirming the positive relation openness-growth, which is interpreted as a demonstration of the consistency of the relationship. Human capital and per capita income are more relevant variables than the degree of openness in six of the nine regressions where the index of openness had a lower value. It is understood that every index of openness “captures” a different aspect of commercial policy and thus, a “composite” index was employed to verify these results. In general terms the previous results were confirmed.

⁶ The evaluations in this section are based on statistics from the World Bank’s World Development Report 1997, the IMF’s International Financial Statistics 1997 the study by Finger, NG and Soloaga (1998) and ECLAC (2003) report.

⁷ This refers to the insular Caribbean, which excludes Mexico.

⁸ In 1968 several Caribbean countries launched their own integration system, the Caribbean Free Trade Area (CARIFTA). In 1973 CARIFTA was replaced by the Caribbean Community and Common Market (CARICOM) which never came close to a common market, in part because the individual islands relied heavily on tariff revenue and in part because intraregional trade was extremely limited. “CARICOM pursued and intensified its efforts to consolidate Caribbean integration but progress has nonetheless been slow, particularly in terms of the common external tariff and the start-up of the Caribbean Single Market and Economy (CSME), which had been scheduled for 2002. Macroeconomic convergence, which is important for these countries progress and integration, will be hard to achieve in the current economic context.” Economic Commission for Latin America and the Caribbean (2003), pp.27-28.

⁹ Observe that Mexico is excluded purposely because although it is part of the member countries of the Caribbean Basin, its membership in NAFTA renders it a special case.

¹⁰ “Chrétien vows to look out for smaller economies, Canada to consider separate regional free trade deal” Andrew McIntosh, National Post, ftaa-l-request@lists.tao.ca, January 20, 2001,

¹¹ *New York Times*. 5 July 2000. “Trade Deal between Caribbean, Cuba.”

¹² See EIU Country Reports (The Economist Intelligence Unit Dec.2000: D, on a scale from A-E) <http://www.eiu.org> and The Heritage Foundation, Index of Economic Freedom (2001: 4.75 on a scale from 0-5) <http://www.heritage.org/index>.

¹³ According to The Economist Intelligence Unit, the level of foreign currency reserves in the Central Bank between 1996 and 1999 has maintained a level of 1.0 (months of coverage of imports), and in 2000 and 2001 was estimated to be 1.2 months in coverage (EIU, Cuba, Country Risk Service, December 2000, p.9).

¹⁴ International Trade Commission – ITC – World Trade Organization, (2002) Trade Information, Country Specific Trade Analysis – Cuba: National Export Performance: <http://www.intracen.org/countries/htm99/cub.htm>

¹⁵ Calculations by the author show that Cuba’s’ imports to the Caribbean were 0.3% on average, with an average standard deviation of 0.8%, and exports were 0.1% on average with a standard deviation of 0.3% in the period between 1990 and 1999.

¹⁶ “In 1996 the value was US \$ 843 billion, 16.2% of which were CARICOM exports. (ECLAC, *Panorama de la Inserción Internacional de América Latina*, 1997).

¹⁷ Further details are described in the section on trade openness and economic growth.

¹⁸ On the role of the protectionist measures in the formation of trade policy in underdeveloped countries see Balassa (1971).

¹⁹ The United States-Caribbean Basin Trade Partnership Act H.R.434, 2000. Trade and Development Act of 2000. (TDA), TITLE II--TRADE BENEFITS FOR CARIBBEAN BASIN, Subtitle A--Trade Policy for Caribbean Basin Countries, SEC. 201. United States-Caribbean Basin Trade Partnership Act. (CBTPA).

²⁰ Taken from Jorge Mario Sánchez E. (1999) "The Economic Relations Cuba - Canada in the 1990s: A Review from the Caribbean" presented at the Annual Meeting of the Canadian Association for Latin American and Caribbean Studies (CALACS): "Latin America and the Caribbean into the Coming Millennium: Equity, Democracy and Sustainability" in Ottawa.

²¹ "The Cubans authorities still have at its disposal, through the fiscal management and the price controls, sufficient tools to maintain the stability macroeconomic", The Economist Intelligence Unit, Cuba, Country Report, 3rd quarter 1999, p8. A similar evaluation issued the same source in its report of November 2002.

²² Marquetti (1999: 24).

²³ Controls in terms of regulations market access, as well as restrictions on the employment of the labor force, leasing of housing, office and pricing systems, create an environment that forces foreign businessman to "adapt" to a situation that is atypical in terms of regional practices.

²⁴ Each simulation is based on on the basis of a country "proxy" made up of: a) Preeg and Levine (1993)—Jamaica, the Dominican Republic and Costa Rica— and, b) Montenegro and Soto (1996)—Jamaica, Dominican Republic and Trinidad and Tobago.

²⁵ This is also known as Tobit model or "canonical censored regression model."

²⁶ WTO- Research Division, Market Analysis, (TradeSim), at:

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