

U.S. Economic and Trade Policy Toward Cuba

Ernest H. Preeg

William M. Scholl Chair in International Business,
Center for Strategic and International Studies

Testimony before the House Committee on Ways and Means Subcommittee on
Trade

May 7, 1998

Thank you, Mr. Chairman, for this opportunity to appear before the Subcommittee on Trade and to state my views about U.S. economic and trade policy toward Cuba. I hold the William M. Scholl Chair in International Business at the Center for Strategic and International Studies in Washington, where my work is heavily involved with trade policy and the Cuba relationship, including my works, *Cuba and the New Caribbean Economic Order* (1993), and [*From Here to Free Trade: Essays in Post-Uruguay Round Trade Strategy*](#) (1998). I am currently engaged in a CSIS project on unilateral economic sanctions, for which I am doing several country case studies, including Cuba.

This hearing is especially timely because circumstances influencing U.S. Cuba policy have changed substantially over the past year, both in Cuba and in the United States, and I believe a fundamental reappraisal of U.S. Cuba policy is in order. You have highlighted four issues as the focus for this hearing, which I will address in turn.

1. The Impact of the U.S. Embargo on the Cuban People.

The U.S. embargo had little impact on the Cuban people for the first 28 years through 1989 because the Soviet Union provided massive economic aid to Cuba, in the order of \$6 billion per year in the late 1980s, while the Cuban economy was isolated from trade with the West. The abrupt cutoff of this aid beginning in 1990, however, led the Cuban economy into financial crisis and a sharp decline in its gross domestic product by half or more, by my assessment, although the Castro government claims the reduction was only 35 percent. Widespread shortages of food, medicines, and other consumer goods caused much suffering for the Cuban people, and although the Cuban economy bottomed out in 1993 and shortages have eased somewhat since then, the economic deprivation continues for most Cubans. Moreover, the prospect is for slow or no growth in coming years as the Cuban industrial base gradually crumbles from the lack of job-creating investment -- gross investment in 1996 was at the incredibly low level of seven percent of GDP.

The issue is how much of this poor economic performance in the 1990s -- and the related suffering of the Cuban people -- is caused by the U.S. embargo and how much by the failed centrally planned economy of the communist government. My assessment is that the failed Cuban policies are principally to blame, but that the U.S. embargo deprives the

Cuban economy of \$1-2 billion per year of hard currency, which is substantial compared with total Cuban imports of goods and services in 1996 of \$4.2 billion.

This \$1-2 billion adverse impact on the Cuban economy from the U.S. embargo comes principally from the prohibition on U.S. imports from Cuba and travel to Cuba by U.S. citizens. The tourism sector is hardest hit. Based on a 60 percent U.S. share of tourists in other Caribbean island nations, the lifting of travel restrictions should increase Cuban tourism revenues by more than \$1 billion per year within a few years. A lifting of the import embargo would also permit significant Cuban exports to the United States of fruits, vegetables, cigars, rum, and other consumer products.

In contrast, the embargo on U.S. exports to and investment in Cuba is having relatively little adverse impact on the Cuban economy. Cuba imports freely from all other countries rather than the United States, at only slightly higher prices, and this includes food and medicine imports addressed further below.

As for foreign direct investment, at this time Cuba is generally not an attractive country in which to invest. Labor costs are extremely high because of a two thousand percent tax on labor levied through regulated wage payments in pesos rather than dollars. In those sectors where investment has been attractive -- hotels, nickel, and the domestic telephone system -- non-U.S. companies have been quick to invest and the Helms-Burton legislation of 1996 has not significantly deterred such viable foreign investments. The hotels are not on expropriated U.S. properties and therefore Helms-Burton does not apply. The Canadian company Sherrit International has invested in nickel production while ignoring Helms-Burton. And the Italian-led investment consortium in the Cuban telephone system avoided Helms-Burton by reaching a private settlement with the U.S. claimant. Only a few relatively small investments in other sectors may have been deterred by Helms-Burton.

Thus the Cuban economy suffers adverse impact from the U.S. embargo through a loss of tourism revenues and potential exports to the United States, which in turn is causing economic pain principally on the Cuban people. Dollars flowing into Cuba are fungible, the Cuban government sets the priorities for their use, and imports of consumer goods have a low priority.

2. Future Prospects in Light of the Pope's Visit.

The Pope's visit will strengthen the position of the Catholic Church as a vehicle for social, economic, and political change within Cuba, but the strengthening will be incremental. A broader result of the visit was to highlight the economic suffering of the Cuban people and to question the adverse impact on them from the U.S. embargo. The Pope has long opposed all economic sanctions -- multilateral and unilateral -- as having little impact on the behavior of authoritarian governments while causing economic pain to the people, and often the greatest pain to the poorest people. The media reporting during and after the trip focused on this inherent dilemma for economic sanctions policy,

which has led to more intense international debate about the purpose and effects of the U.S. Cuba embargo.

This debate is most important within the United States because all other countries agree with the Pope and officially oppose the U.S. Cuba embargo. Within the Cuban-American community, which has been a forceful advocate for tightening the sanctions, an open split has emerged, although the pro-embargo faction remains in the majority. The U.S. private sector has become more organized and forceful in its opposition to unilateral sanctions and editorial comments run more heavily against the Cuba embargo in the wake of the Papal visit.

Two specific policy developments in the United States since the Pope's visit are President Clinton's actions in March to ease restrictions on travel and humanitarian assistance and growing support for legislative proposals in both houses of the Congress to unilaterally raise the embargo on exports of food and medicines to Cuba. Of the President's actions, the most significant is the renewal of direct flights from Miami to Havana for Americans legally permitted to travel to Cuba, principally Cuban-Americans. Reports are that scheduled flights are fully booked and that there will be many more flights than there were before they were suspended two years ago. Moreover, Cuban-Americans traveling to Cuba now are less intimidated by the pro-embargo majority, and include younger generation Cuban-Americans questioning the longstanding embargo policy.

The legislative proposal to lift the embargo on food and medicine exports is a win-win proposition for the United States. As noted earlier, it would not provide significant additional dollars to the Castro government while taking away Castro's unjustified propaganda argument that the embargo on these products is a cause of food and medicine shortages in Cuba. It would also be a symbolic gesture of understanding for the pressing humanitarian needs of the Cuban people. The proposals have well over a hundred co-sponsors in the House and more than twenty in the Senate. A significant number of these have signed on in light of the Pope's visit. I would urge an early hearing and vote on this legislation, and hope that a bipartisan majority will vote in favor.

3. Humanitarian Assistance Extended to the Cuban People.

The financial crisis and economic suffering in Cuba during the 1990s have evoked a strong response from abroad to provide humanitarian assistance to the Cuban people. A principal difficulty in doing this is to assure that such assistance gets directly to the people and is not simply acquired by the government for its own purposes. Church groups and other non-governmental organizations (NGOs) are appropriate channels, but it can be a slow and difficult process to get established in Cuba. The Catholic Church humanitarian assistance agency, Caritas, is the largest and most successful NGO conduit by far. As to the source of such NGO support, U.S. assistance is far larger than all other country contributions combined.

This church and other NGO humanitarian assistance, however, is relatively small by comparison with the surge of remittance payments of dollars to Cuban families from the

Cuban diaspora, principally Cuban-Americans. Such remittances increased from the order of \$100 million per year in the early 1990s to an estimated \$600-800 million per year in 1995-97. The U.N. Economic Commission for Latin American and the Caribbean estimates the remittance level at \$600 million in 1995 and \$800 million in 1996, based largely on an otherwise unexplained increase in the Cuban current account deficit of more than \$1 billion per year. The Cuban government estimates up to a \$700 million level in 1997 related to sales in "dollar only" stores, which were established in 1994 in large part to attract such dollar remittance flows into Cuba.

A qualitative advantage of this humanitarian dollar inflow is that all the dollars stay in the country to buy basic necessities whereas, in contrast, more than half of gross tourist receipts are used to pay for tourist-related imports. When taking account of this "gross-net" differential, the estimated remittance payments provide more dollars to the Cuban economy than either the tourism sector or sugar exports.

Remittance payments from the Cuban diaspora are at least several times larger than church and other NGO humanitarian assistance combined, and as such present a dilemma for the Cuban-American community in particular. Many Cuban-Americans strongly support the embargo, which is designed to inflict economic pain on the Cuban economy, while providing large amounts of humanitarian-based remittance payments which negate the economic impact of the embargo policy. In effect, the remittance payments are a response to the Pope's message that economic sanctions hurt the people. Comparing the size of the remittance payments to the Caritas program in Cuba, Cuban-Americans are indeed more Catholic than the Pope!

4. The Impact on Relations with U.S. Trading Partners.

The impact of the U.S. embargo on U.S. trading partners consists of two elements that are in basic conflict. It is a matter of what they do and what they say. The larger impact by far is that the unilateral embargo precludes U.S. exporters and investors from the Cuban market, while leaving it open to the benefit of all competitors. This did not mean much before 1990, when the Cuban economy was integrated with the Soviet Bloc, but the adverse impact on U.S. commercial interests has since become substantial. The United States is the natural market for Cuban trade and investment as it is for economies throughout the Caribbean Basin, and with normal commercial relations, the United States could expect a 60 percent or more share of the Cuban market. In 1996, Cuban imports were \$4.2 billion, and in the absence of the embargo, such imports would rise to \$5-6 billion (from dollar inflows from increased tourist receipts and Cuban exports to the United States as explained above). On this basis, U.S. export losses would be in the order of \$3-4 billion per year compared with trade relationships elsewhere in the Caribbean basin. This market would not be obtained immediately for U.S. exports upon the lifting of the embargo, but it is a potential target level in a market now totally abandoned to third-country competitors.

The gains to other countries in the area of investment is more difficult to quantify. A five-star hotel on a prime beach location can involve a \$30 million investment (based on a 50

percent equity share), but the returns over ten or twenty years can be far larger. Similarly, the moderate initial investment to rebuild the domestic Cuban telephone system, utilizing European rather than U.S. technologies, can have a multiple future return.

The second, largely conflicting element of the impact on trading partners concerns their stated official opposition to the embargo and to the extraterritorial dimension of the Helms-Burton Act, in particular, which attempts to restrict third-country investment in properties with outstanding U.S. expropriation claims. This has caused bitter disputes bilaterally and within the World Trade Organization (WTO). The EU called for a WTO dispute panel and the United States protested on grounds that the Helms-Burton measures are about foreign policy not trade policy, and that if the EU pressed its case the United States would claim a "national security" exemption under Article XXI of the GATT. On both counts, the U.S. position is without merit and tends to undermine U.S. support within the WTO. Many trade policy measures are related to foreign policy but this in itself is not grounds to violate WTO commitments. As for GATT Article XXI, the national security exemption is only permitted under the narrowly defined circumstances of "war or other emergency in international relations," and the United States, as the preeminent global power, would look foolish and be juridically vulnerable to claim such a current relationship with the small, withering communist regime in Cuba.

The United States and the EU are attempting a negotiated resolution of the WTO dispute over Helms-Burton and the outcome is uncertain. In any event, U.S. leadership within the WTO has suffered, as has public support in the United States for the WTO, which has been continually criticized by strident supporters of Helms-Burton. The failure of President Clinton to obtain "fast track" legislation last year reflected a public opinion that has turned against the longstanding U.S. liberal trade policy, and the many attacks on the WTO as undermining U.S. sovereignty by Helms-Burton supporters contributed significantly to this failure.

Bringing these two elements of impact on trade relations with others together, there is finally the question of whether our trading partners -- and Fidel Castro -- really want the United States to lift the Cuba embargo as they say they do. Foreign business interests clearly enjoy an inside and now exclusive track in a growing market that normally would be dominated by the United States. Trade missions to Cuba are actively promoted by European governments. The CEO of Sherrit International is outspoken in public condemnation of Helms-Burton, but his private preference reportedly is for the embargo to continue as long as possible in order to broaden investment interests in Cuba in the absence of American competitors.

As for Fidel Castro, my personal assessment, based on decades of his highly successful nationalist, anti-U.S. posturing, is that the last thing he would want to see is a lifting of the U.S. embargo. And if this assessment is correct, the entire rationale for current U.S. economic and trade policy toward Cuba is open to serious question.