What options for a Soviet-bloc nation—and Western bankers—when the USSR declines to be lender of last resort?

CUBA IN THE RED

by Wilson P. Dizard, III

[H]as not Batista jeopardized the credit of the country for 30 years? Has not the public debt increased to more than 800 million pesos? Is there not a deficit of more than 100 million? Are not the monetary reserves of the nation pledged to foreign banks in a desperate search for money? Were not 350 million pesos of the most recent loan wasted on the purchase of jet planes and things of that nature, without plan or program, for no other reason than personal whim? Can one play in this manner with the destiny of a nation? Did anyone authorize him to undertake these insane credit ventures? Did he consult the people in any way?...It is for us more than anyone else to be concerned because we and future generations will have to pay the terrible consequences of that corrupt and unchecked policy.

—Fidel Castro, Manifesto No. 1 to the People of Cuba, August 8, 1955

In the spring of 1982 the Cuban American National Foundation in Washington, D.C., published a report that predicted that Havana's hard currency debt to Western banks and governments was "unmanageably large and headed toward a crisis." On August 31, 1982, the Banco Nacional de Cuba (BNC) announced its intention to reschedule approximately half of its roughly \$3 billion of hard currency debt. In early January, 1983, the Cuban Government suspended payments on the principal of that debt.

Two key issues discussed in the 1982 foundation report were the possibility of Soviet backing for Cuba in its debt difficulties and the uses to which the Castro regime has put the funds raised from Western banks and governments. Because some of the credits Havana had received from Western banks were not linked to any particular project, they were available for use in Cuba's Soviet-inspired military adventures in Latin America, Africa, the Middle East, and Asia. If the borrowed funds were not used directly to fund these operations, they were certainly available to replace assets that had been diverted to these military endeavors.

When Cuban government officials visited Tokyo to outline their proposal for rescheduling the debt to Japanese banks, speculation on the first of the issues was put to rest. They surprised Japanese bankers by indicating that the Soviet Union would *not* serve as a lender of last resort for the Castro regime. Some of the BNC's foreign creditors remained unconvinced, however, and at a meeting of its creditors held in Paris in November, 1982, the delegate from the United Kingdom pointedly referred to the possibility that the Soviet Union could lend Cuba the hard currency it needs.

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In the same month a high-level delegation of European and Japanese officials representing the treasury ministries of nations that have extended credit to the Castro government met in Havana to begin discussion on the rescheduling of Cuba's debt. Among the nations affected are France, Japan, Germany, Spain, Italy, Argentina, Canada, Mexico, and several in the Arab world. (Cuba's debt consists of both trade credits extended by government agencies and loans from private banks. Negotiations with the government agencies will set the pattern for subsequent talks with international banks.)

The rescheduling itself came as no surprise to international banking circles, which long had been aware of the vulnerability of the Cuban economy. Bankers in Western Europe, Canada, and Japan who had arranged loans for Cuba were, however, taken aback by the terms now being sought. The BNC, its motives variously described as "arrogance" and "naiveté," was demanding a ten-year rescheduling period to be initiated by a three-year grace period, during which the payment on medium and long-term debt principal would be suspended. Havana rested this proposal on several conditions intended to protect Cuba's short-term loan arrangements, which were not being rescheduled. The Banco Nacional de Cuba asserted that Cuba is "a special case" and deserves preferential treatment from its creditors. According to government authorities, "Cuba is a country under aggression and therefore requires conditions that mitigate the consequences of aggression."

The BNC's demand for "special treatment" was met with coolness. As the *Financial Times* of London put it: "Cuba can make no claim for privileged treatment by the West on either political or economic grounds." To the contrary, "It is obvious that Western banks need not rush to the help of a government whose economic sectarianism and whose willingness to sacrifice its own people's living standards to foreign campaigns has left its finances in a perilous state."

THE CUBAN PROPOSAL

The Castro government's economic leaders spearheaded their rescheduling campaign by releasing a sixty-sevenpage "Economic Report," a curious document consisting chiefly of excuses and rationalizations for Havana's economic crisis. Of the relatively few statistics provided, many are transparent fabrications.

The thrust of the report was to assign blame for the negative aspects of the Cuban economy to the U.S. or the pre-1959 governments. For example, a series of statistics purport to show that the Castro regime inherited a chronic trade deficit. In fact, Cuba ran a consistent trade surplus during the 1950s, with the exception of 1958, when trade was disrupted by guerrilla activities. Similarly, the report states that the infant mortality rate in the period immediately preceding the 1959 revolution was 60 per thousand live births. This conflicts with reports by the Pan American Union and the World Bank, which put the figure in the range of 36 to 38 per thousand. The BNC asserts that in 1959 a Cuban's life expectancy was 53 years, while the World Bank offers the figure in 1960 as 64 years.

While the BNC's intent in publishing these social data was to propound the official ideology, which assigns all positive developments in Cuba to the successes of the present regime, their publication tended to cast doubt on the veracity of the financial statistics presented in the report, thereby undermining the regime's credibility among its creditors. *Not* addressed in the Economic Report is one of the great imponderables of Cuba's economic future: the day in 1986, fast approaching, when Cuba must begin repaying its debt to the Soviet Union, estimated at nearly $7 billion.

THE CRISIS: CAUSES & OPTIONS

At the root of Cuba's debt rescheduling problems are its Soviet-style command economy, high interest rates around the world, and fallen sugar prices. These factors are compounded, in turn, by low worker morale, leading to stagnant productivity and high rates of absenteeism. Despite efforts to counteract these trends by mobilizing large segments of the population for "voluntary" work, the prevailing impression among Cuban workers is that personal economic advancement is unlikely under the current system, hence the pressure to emigrate represented by the Mariel exodus of 1980. Additional evidence of worker disaffection has been provided even in the speeches of high Cuban government officials, including General Raul Castro Ruz, Fidel Castro's brother and the number two man in the government. In a speech in December, 1979, General Castro criticized widespread absenteeism, shirking, falsification of statistics, and other lapses of labor discipline. In recent years the regime has attempted to counteract these practices with coercion in the form of the massive price increases instituted in December of 1981 and through incentives in the form of cars, appliances, and vacations.

Cuba's major short-term problem has been the coincidence of falling sugar prices and higher interest rates. Much of Cuba's debt is linked to the volatile "Libor" (London Interbank Offering Rate—the interest paid by major British banks on loans to each other), which rose as a result of the U.S. Federal Reserve's tight money policy. Recent changes in the Fed's policy that have led to lower interest rates might be expected to help Havana reduce its interest costs, but this will be counteracted by two factors: Since interest rates are generally set on a half-yearly basis and calculated from interest rates prevailing in the preceding six months, there will be a delay before Havana's interest costs drop. At the same time, the premium over Libor charged by new lenders will increase as a result of the rescheduling itself. According to one report, bankers are likely to demand a 1 per cent "front-end" fee and an increase in interest rates to 1.75 per cent over Libor. This would represent an increase of approximately .5 per cent in the premium over the floating rate.

First option: sugar. Cuba's excessive reliance on sugar ties the economy's convertible currency prospects to the fluctuations of an essentially uncontrollable commodity price. While the bulk of Cuba's sugar crop is sold to the Soviet Union at artificially high prices under the so-called "slippery price system" (which also provides for sales of oil to Cuba by the Soviet Union at artificially low prices), these transactions do not generate the hard currency needed for repayment of Western debts. It should be mentioned in this connection that trade with the Soviet Union, despite these concessionary terms, has in recent years generated an imbalance in favor of the USSR. The price of Cuban exports to the Soviet Union were at one stage indexed to the expense of Cuban imports from that country so that trade would balance automatically. However, this arrangement has changed in recent years to Cuba's disadvantage: In 1979, Cuba had a $186 million trade deficit in bilateral trade with the Soviets, which increased to $670 million in 1980.

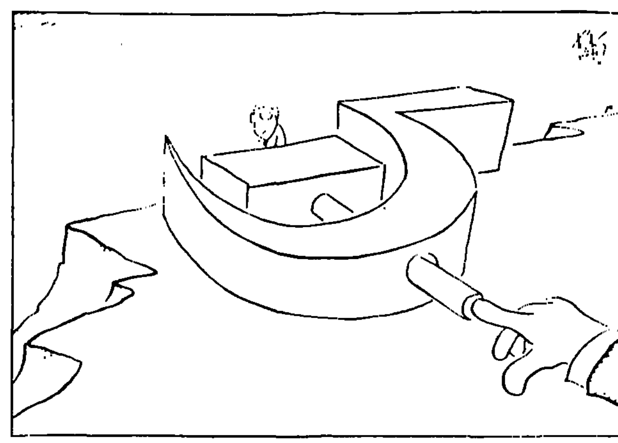
Diversification of the economy was one of the original goals of the 26th of July Movement, Castro's organization in the early days of the Revolution. As early as August, 1955, in the "Manifesto No. 1 to the Cuban People," Castro called for "immediate industrialization of the country by means of a vast plan made and promoted by the state." These efforts have not met with success, and Cuba is now more dependent on sugar than it was before the Revolution. Nor has this activity itself been fully industrialized, since the bulk of the sugar exported to the Soviet Union is in raw form for processing there.

Second option: tobacco, citrus, and nickel. The disappointing outlook for sugar raises the question of Cuba's other export industries. The tobacco industry is in a period of recovery from the blue-mold disease that crippled the crop in 1979 and 1980. Though Cuba is a net exporter of tobacco, it has been importing some of the leaf recently to build up inventories depleted by the blight. A good crop was harvested in 1982, but the damage to stored tobacco caused by hurricane "Alberto" held down the recovery of tobacco exports. Tobacco is Cuba's most famous export after sugar, but its proportion of total exports is less than 5 per cent in most years.

Citrus production continues to lag behind planned goals. Last year's output of 160,000-170,000 tons fell far short of the projected 270,000 tons. Due to the low quality of the product, it is unsuitable for the world market and so is shipped to CMEA (Soviet bloc) countries.

Prospects for increased nickel production, another export, are not bright. Cuba's Soviet and CMEA allies have promised to build two new plants to raise production to a level of 100,000 tons annually (compared with the current output of approximately 40,000 tons), but disagreements over plant design have delayed completion of these projects until 1985 at the earliest. Meanwhile, nickel processing will continue at two confiscated U.S. plants. These obsolete facilities date from the era of low oil prices and so consume far more oil than do the modern plants in countries competing with Cuba.

The nickel industry worldwide is in the grips of a recession that has idled most of the industry's capacity and led to the buildup of large inventories, as in the case of sugar. Top U.S. nickel experts are skeptical of the Cuban Government's ability to expand production according to its goals. They point out that Cuba's laterite ore requires much more energy-intensive processing than do sulphide ores from Canada and other exporters. As with other goods, Cuban nickel exports are subject to the U.S. embargo, so the Cuban Government at times has attempted to "launder" them through France and the Soviet Union—only to be caught.



Third option: tourism. Tourism is Cuba's most obvious potential resource: It is abundantly endowed with the natural resources of topography, climate, and the sport fishing available in coastal waters. And tourism has the advantage of being labor-intensive and nonpolluting.

Before 1959 the island attracted 300,000 tourists each year, principally from the United States, a trade known as "the second sugar harvest." Tourism development is, in fact, one of the Castro regime's top priorities. Cuban authorities hoped to attract 200,000 visitors in 1982; however, in 1981 the industry earned only $80 million in hard currency. By contrast, Jamaica's tourism revenue was $263 million that year. Again, politics was the stumbling block: The Reagan administration has effectively curtailed American tourism in Cuba, charging Castro's continuing military adventurism.

Despite new legislation designed to encourage foreign investment in tourist facilities, prospects for such investments in the Caribbean as a whole have suffered due to the recession in the developed countries. One legal expert has indicated that Cuba's new foreign investment law that aims at relaxing rules for foreign investors is permissive rather than mandatory; i.e., it does not bind the Cuban Government to observe its provisions but, rather, allows it to apply them at its discretion. This aspect of the legislation is unlikely to reassure investors, who recall the present status of claims by U.S. investors against the Castro regime for the unreimbursed expropriation of foreign property in the early 1960s.

Fourth option: domestic austerity. Havana's rescheduling is also complicated by the fact that Cuba is not a member of the International Monetary Fund, which usually participates in these negotiations and acts as a referee to ensure implementation of the austerity measures needed to put the debtor's financial house in order. Anticipating the bankers' demand for fiscal responsibility, the BNC's Economic Report offered a seven-point program, which included:

- restriction on economic growth so as to keep hard currency imports at a minimum;
- concentration on CMEA-supported investment projects;
- priority attention to integration with CMEA countries;
- use of increased export revenue or new credits to build up monetary reserves;
- a search for joint ventures with Western companies in tourism, shipping of exports, and service industries under the new foreign investment law;
- promotion of sales to foreign countries of civil engineering services and technical knowhow;
- efforts to stabilize world sugar prices, notably by discouraging subsidized beet-sugar exports by the European Economic Community.

The brunt of the austerity measures ("restriction of economic growth so as to keep hard currency imports at a minimum") is unlikely to fall on the Party, the military, or government elites, leaving the mass population to bear the burden.

Fifth option: opening toward the U.S. Before the 1959 Revolution the U.S. accounted for 75 per cent of Cuba's exports and 65 per cent of its imports. At least one official in Havana has expressed the hope, as quoted in *The Economist* last June, that "the United States could still be our most important economic partner." However, U.S. officials maintain that improved economic relations hinge on changes in Castro's aggressive promotion of subversion in Africa and Latin America and are perhaps most deeply concerned about Cuban support of terrorism in Puerto Rico. Last December, Thomas O. Enders, assistant secretary of state for inter-American affairs, speaking before the House Subcommittee on Inter-American Affairs, noted that "in very high-level secret talks, our negotiators explored a series of steps with the eventual goal of removing the embargo and full diplomatic relations, in return for curbs on Cuban activities in Puerto Rico and a gradual withdrawal of more then 20,000 Cuban troops from Angola."

The U.S.-Cuban agenda has been clouded lately by the indictment of four high officials of the Castro government on charges of smuggling narcotics into the United States. The smuggling appears to have had a substantial short-term financial benefit for Havana, owing to the high fees smugglers pay for use of Cuban waters and ports for refueling and transfer of contraband from large vessels to smaller ones. However, the long-term effect of further poisoning relations with the U.S. Government will certainly exceed the short-term financial benefits.

NEGOTIATIONS

Despite gloomy economic prospects, the BNC has been somewhat successful in continuing to finance its short-term hard currency trade. In November, agreements were signed with French, Spanish, and Arab banks for short-term trade financing. Though these pacts run for only ninety days, Cuban bankers expect they will be renewed.

The most recent development vis-à-vis Cuba's debt rescheduling has been the attempt by the BNC to form a steering committee to negotiate their debt to private banks. Members of this group had their first meeting in Paris last December 6 together with representatives of the Banco de Bilbao, Crédit Lyonnais, the Deutsche-Südamerikanische Bank (a subsidiary of the Dresdener Bank), the Gota Banken of Sweden, the Industrial Bank of Japan, the Midland Bank (U.K.), the National Bank of Canada, the Banco Arabe Español, and Kreditbank (Austria).

One participant in the December 6 meeting indicated that the group of banks did not constitute a steering committee in the usual sense of the term. For example, the participating banks did not have the power to negotiate on behalf of other banks in their home countries. During the meeting, which was chaired by Crédit Lyonnais, the attendees informed Cuban government leaders that negotiations with the private banks would hinge on the outcome of talks now going on among an ad hoc group of central bank officials representing government lenders. The Cuban Government was also informed by the private banks that it would have to provide more information on its financial status and that it would have to pay the expenses of bankers who attend such meetings. What is more, they could offer no guarantees that existing lines of credit would be maintained. No future meeting of this group, or any other assortment of Cuba's private lenders that might eventually form a true steering committee, was scheduled, and apparently none will be held until sometime this year.

The United States Government is influencing negotiations obliquely by holding out the threat of participation on the basis of approximately $80 million in Export-Import Bank credits extended to the Cuban Government prior to 1959 that were not repudiated by the Castro regime. However, Havana will not negotiate on a multilateral basis with a group that includes the U.S. If the United States were to press its case, the negotiations would splinter into a series of bilateral deals, and lenders would have much less leverage in imposing economic conditions on the Castro government as a condition for debt rescheduling. The U.S. therefore is remaining in the background while casting its long, silent shadow.

As Cuba struggles to deal with its current credit problems, Fidel Castro's prerevolutionary indictment of the Batista government echoes with an ironic ring:

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