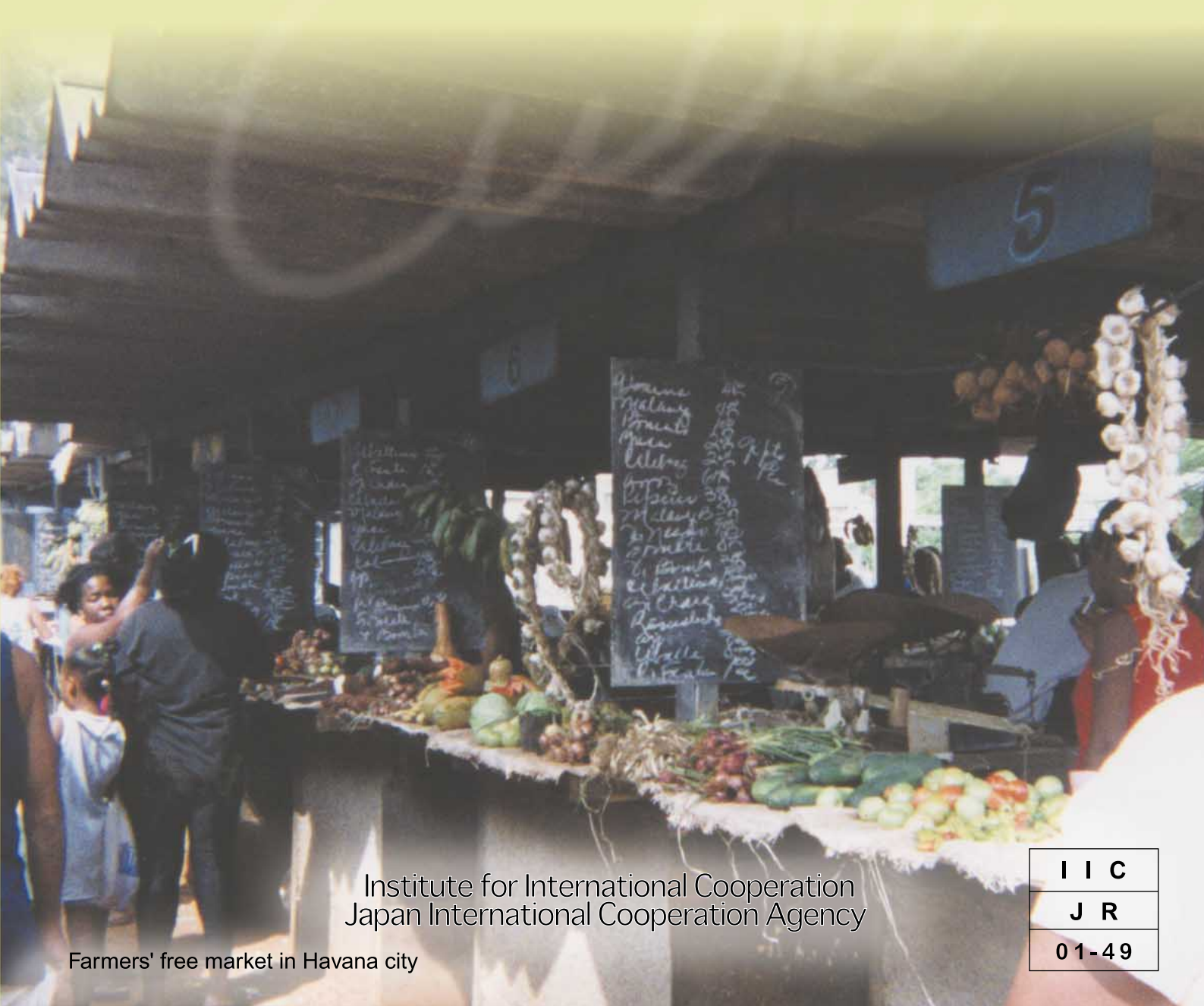


The Republic of Cuba

Soft landing to a market economy and democracy
coexistent with social fairness

March 2002



Institute for International Cooperation
Japan International Cooperation Agency

Farmers' free market in Havana city

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Country Study for Japan's Official Development Assistance to the Republic of Cuba

Soft landing to a market economy and democracy
coexistent with social fairness

March 2002

Institute for International Cooperation
Japan International Cooperation Agency

This report was prepared based on the discussion and findings of the Country Study Committee for Japan's Official Development Assistance to the Republic of Cuba by Japan International Cooperation Agency (JICA). The views expressed in the report are those of the members of the Study Committee and do not necessarily reflect those of JICA.

This report can be downloaded in PDF format from the JICA homepage
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Foreword

There is a growing need to deal with globally pertinent issues such as environmental degradation, population growth and food supply in developing countries in which Japan International Cooperation Agency (JICA) has been deeply involved. In the process of program implementation, it is necessary to pay close attention to particular characteristics and the development level of each host country. Based on this perspective, JICA has conducted country/region-specific studies, with the involvement of external academics and researchers. JICA has so far established a total of 37 Country Study Committees for Japan's Official Development Assistance (ODA) and compiled and published reports based on the discussions and findings by the Committees.

Cuba experienced serious socio-economic deterioration, represented by negative GDP growth of 35 percent, after the collapse of socialist regimes in the USSR and Eastern Europe. The government implemented a series of economic reforms starting around 1993, and the economy has been recovering since 1995 backed by a favorable turn of international markets for primary products. Nevertheless, people's living conditions are still full of deficiencies.

The government of Japan has thus far focused on technical cooperation, such as the acceptance of trainees, while the government of Cuba has submitted various kinds of requests for Japanese assistance. However, due to the lack of adequate interactions between the two countries in the past, information and data concerning Cuba are scarce in Japan. Therefore, JICA decided to organize the Country Study Committee for Japan's Official Development Assistance to the Republic of Cuba to analyze the current conditions of Cuba, challenges faced by the country and the possible direction of its development as well as to write recommendations/suggestions about future Japanese assistance to the country from a medium-term perspective.

The Study Committee was made up by Professor Keiichi Tsunekawa of the University of Tokyo (Chairperson) and six other Members and Resource Persons including academics, researchers and JICA staff. They were involved in enthusiastic discussions at the Committee meetings as well as via email. They also conducted interviews with relevant parties in Japan, Cuba and the United States.

JICA will make a full use of this report as an important resource material to formulate and implement future projects for Cuba. It also hopes that other organizations engaged in cooperative activities in Cuba will utilize this report for planning and implementation of their projects.

Finally, I would like to express my deepest appreciation to the Chairperson, Professor Tsunekawa, as well as the other members of the Committee who spared no effort to accomplish this study. I would also like to thank all the people and organizations that facilitated the activities of the Study Committee.

March 2002

Takao Kawakami
President
Japan International Cooperation Agency

Preface

This report is a result of a five-month study commissioned by Japan International Cooperation Agency (JICA) in November 2001 and conducted by the Country Study Committee for Japan's Official Development Assistance to the Republic of Cuba.

Cuba has firmly maintained its existing system even after the collapse of the socialist regimes in the USSR and Eastern Europe. It is, therefore, generally viewed as a "socialist country;" it is often overlooked that it is an "underdeveloped country" dependent on the export of agricultural products and mineral resources, both before and after the revolution. In fact, since the termination of assistance from the USSR and Eastern Europe, the country has been suffering a serious shortage of hard currency, which makes it difficult to secure investment money and adversely affects the living standard of the people. In this sense, Cuba is, before being a socialist country, a typical underdeveloped country eligible for ODA.

Despite this fact, the absence of diplomatic relations and occasional hostile incidents between the U.S. and Cuba have made Japan hesitant to expand its ODA commitment to Cuba. However, hard-line Cuban Americans are on the decrease, partly due to the generational change in recent years. Furthermore, U.S. business people, especially from agriculture and the pharmaceutical industry, have become anxious to reestablish trade relations with Cuba. Accordingly, although the future path could be affected by the policy line of individual U.S. policymakers, relations between the two countries are expected to improve gradually. In fact, in November 2001, the U.S. administration authorized the export to Cuba, for the first time, of foodstuffs and pharmaceuticals in a sum equivalent to US\$30 million under the pretext of humanitarian assistance to redress damage caused by Hurricane Michelle.

To cope with economic difficulties caused by the cessation of assistance from socialist countries, Cuba has been implementing reforms that can potentially contribute to its transition toward a market economy. The reforms include (i) permitting self-employed businesses, (ii) lifting the ban on holding and spending foreign currency, (iii) reopening farmers' free markets, (iv) permitting 100% foreign owned enterprises, and (v) reform of state-owned enterprises (SOEs) aimed at increasing their financial autonomy. The speed of the reforms is rather slow, but retreat is no longer likely. In addition, although these economic reforms will not lead Cuba automatically toward democratization, the increase of autonomous actors born out of reforms will boost long-range progress toward political reforms, liberalization and democratization.

Now that the issue of post-Castro Cuba has to be considered seriously, EU countries and Canada are strengthening their "constructive engagement" policy. Japan should also expand its technical cooperation to Cuba from the perspective that Cuba is an ODA-eligible "underdeveloped country" and that assisting the current reforms can help the eventual transition to a market economy and more open political regime. Japan's cooperation should focus on environmental issues such as marine pollution and soil deterioration, the strengthening of legal and judicial systems and on fostering human-resource development. Detailed explanations are provided in Chapter 2 under the title "Direction and Challenges of Medium-term Development of Cuba" and Chapter 3 entitled "Proper Approach for Japan's ODA to Cuba."

The year 2002 marks the centennial of the first contact in modern ages between Japan and Cuba. Upon the independence of Cuba in 1902, President Estrada Palma sent a letter to Emperor Meiji notifying him of Cuba's independence and his own inauguration as President, and the Emperor answered with a letter wishing for the

development of mutual friendship. In this commemorative year, I sincerely hope that this report will serve as a useful reference by those who are engaged in interchange and cooperation with Cuba.

Lastly, I wish to extend my deepest gratitude to the Members and Resource Persons of the Committee for their contribution and collaboration in compiling this report. This study was assisted by many people and institutions: Japan's Ministry of Foreign Affairs, the Cuban Government, organizations of the United Nations, and the Japanese Embassy in Cuba, which we visited on the occasion of our field survey. People at the Secretariat of the Study Committee located in the Institute for International Cooperation, JICA, were also highly helpful. On behalf of the Committee, I express my heartfelt appreciation to all.

March 2002

Keiichi Tsunekawa, Ph.D.
Chairperson,
Country Study Committee for
Japan's Official Development Assistance to the
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Background of the Study

Purpose of the Study

While maintaining a communist one-party regime, Cuba has been carrying out economic reforms since 1993. These can potentially lead the country to an eventual transition to a market economy. However, there has been no noticeable improvement in the human-rights record, although the Cuban government released some political prisoners when the Pope visited Cuba in January 1998. EU countries and Canada have provided Cuba with various forms of cooperation including direct investments in the hope that “exposing Cuba to the world wind” may contribute to encouraging democratization in Cuba; while the U.S. government has reduced economic sanctions to some extent in consideration of the mounting demand for relaxation from its business community.

Japan has thus far extended its assistance to Cuba mainly in the form of technical cooperation such as the acceptance of trainees, in addition to limited financial assistance called “Grant Assistance for Grassroots Projects” and “Emergency grant aid.” In October 2000, JICA sent to Cuba a Project Identification Mission to discuss the future of bilateral cooperation with the Cuban government. Concurrently, it conducted two Project Formulation Studies, one on the environment and the other on agricultural and rural development, and decided to station a Project Formulation Advisor in Cuba for a long-term assignment. Requests made by the Cuban government are currently under study and consideration.

However, reflecting the past history of limited mutual interactions, Japan has scarce information and data on Cuba. In order to analyze the current status and development challenges of Cuba, JICA formed a study group called the Country Study Committee for Japan’s Official Development Assistance to Cuba. The Committee was expected to make policy recommendations on Japan’s Official Development Assistance (ODA) to Cuba, particularly on JICA’s assistance policy in the near future.

Study Committee and Report Preparation

This Study Committee consisted of seven Committee Members/Resource Persons and was chaired by Dr. Keiichi Tsunekawa, Professor of the Graduate School of Arts and Sciences, University of Tokyo (see List of Committee Members and Resource Persons).

The Committee, established in November 1, 2001, held three plenary meetings, in addition to conducting a field survey in Cuba and the U.S. to obtain information and exchange opinions with concerned parties from various Cuban agencies and research institutes, U.N. officials, Japanese diplomats, donor-community people and American scholars. Listening to opinions of other relevant parties at home and abroad, this report, prepared by Dr. Tsunekawa, was completed in March 2002.

Structure of the Report

The report provides the result of the research and discussion by the Study Committee. The first Chapter of the report summarizes the current status and problems of Cuba. The proper direction and major challenges for medium-term development of Cuba are discussed in Chapter 2. Based on these analyses, Chapter 3 presents policy recommendations on Japan’s ODA to Cuba that the Study Committee believes most appropriate. A matrix attached summarizes current status and major development challenges of Cuba as well as principal tasks for Japan’s assistance to Cuba.

Abstract

Due to the collapse of the socialist regimes in Russia and Eastern Europe, Cuba experienced severe economic recession in the early 1990s. Even after implementing a series of economic reforms, Cuba is still characterized by its “underdeveloped” economy. On the political front, Cuba has maintained the socialist regime led by Mr. Castro since the 1959 Revolution. Another characteristic of contemporary Cuba is political and ideological supremacy over economic flexibility.

Now that Cuba faces severe economic conditions and international environment, she will not be able to retard economic reforms under the current socialist government. As Cuba deepens interactions with foreign countries including the United States, the transformation will be further encouraged.

This report recommends that Cuba should advance toward a “soft landing to a market economy and democracy coexistent with social fairness.” Cuba needs to quicken its transition to a market economy, responding to the challenges such as the elimination of the dual economy and the alleviation of the hard currency bottleneck. These reforms, on their part, require efficient and transparent governance. At the same time, Cuba should reorganize its social services to ensure a minimal social safety net under the budget discipline and tackle environmental problems such as water contamination and soil degeneration.

Japan can assist such Cuban efforts through expanding its ODA. The transformation of Cuba, in turn, is beneficial for Japan for various reasons. Finally, the report recommends concrete assistance measures: (1) promotion of sustainable development, (2) assistance to Cuba’s efforts for political and economic liberalization, (3) cooperation to reform Cuba’s policy for the socially weak, and (4) combination of Cuba’s human resources with Japan’s technical resources to help the third countries.

Chapter 1 Current Status of Cuba

1. Evolution of Reforms during the 1990s

Development Challenges Faced by Cuba

In spite of the collapse around 1989 of socialist regimes in the USSR and Eastern Europe, Cuba continued to maintain its socialist regime. Accordingly, Cuba is generally viewed as a “socialist country,” and it is often overlooked that it is an “underdeveloped country,” which has had to depend, both before and after the revolution, on the export of agricultural products and mineral resources. In addition, the revolutionary government has directed energetic efforts to the improvement of education and medical services, thus generating a strong image of Cuba as being advanced in social services as compared with other developing countries. Again it is often overlooked that this high level of social development was made possible only by the assistance of the USSR and Eastern Europe, which reached astronomical figures.

The structure which has caused underdevelopment of the Cuban economy is a legacy of colonial days when this island country was forced to specialize in sugar production. The monoculture of sugar production was further strengthened when the Cuban sugar industry came to be closely tied with the U.S. market and capital during the period extending from the 19th century to years following independence.

Castro’s revolutionary government aimed to move away from the monocultural economy and its excessive dependence on the U.S. after 1959, but except for the change from dependence on the U.S. to that on the USSR, no substantial improvement has been made. This is demonstrated by the symbolic fact that the barter trade of Cuban sugar for Russian crude oil on terms extremely favorable for Cuba supported the Cuban economy. Both before and after the revolution, the Cuban economy has been sustained by fragile income sources such as the export of sugar, tobacco and nickel, and tourism, which remain insecure as they are largely subject to fluctuations of international prices, climatic conditions, and natural disasters. In short, Cuba should be regarded as a typical underdeveloped country.

Commencement of Economic Reforms

Cuba faced a severe economic crisis after the collapse of the USSR and Eastern European regimes. Its GDP, which was already low, registered negative growth for four consecutive years after 1990, with total decline amounting to 35 percent. In this situation, economic reform became unavoidable. Concurrently, however, the former USSR and Eastern Europe were implementing the “Big Bang” reform, i.e., rapid transition toward a market economy, and their societies and economies were in serious turmoil. Mr. Castro, a firm believer in socialist ideals, had no intention to promote a market economy that contains the risk that Cuba would fall into social disorder and surrender to the U.S., but reluctantly initiated a series of economic reforms in order to revitalize production. Triggered by the fourth Communist Party Congress held in October 1991, the reform commenced in full swing from 1993. It included a wide range of policies that permitted self-employed businesses, lifted the ban on holding and spending foreign currency, reopened farmers’ free markets (*mercados agropequeros*), permitted investment by 100% foreign enterprises, and obliged state-owned enterprises (SOEs) to be financially autonomous. Whatever Mr. Castro’s real intention was, these programs had the potential to enable Cuba to make a great economic stride toward a market economy if they had been advanced.

As a result of the reforms, and also backed by a favorable turn of international markets for primary products, the Cuban economy began to pick up around 1995, and the GDP as of 2000 recovered up to 80 percent of the 1989 level. The *Paladares* (self-employed restaurants), symbols of new self-employed business, were great successes. While the production of agricultural goods such as sugar cane, milk and beef, sale of which in free markets was not permitted, increased only slightly from 1995 to 2000, the production of vegetables, rice and corn, which could be sold on the free market, tripled. By the year 2000, foreign corporations, mainly from Europe and Canada, invested in 374 joint ventures in such fields as hotels, mining, oil refineries and cement. Both the invested funds and operational incomes of these foreign companies contributed to Cuba's acquisition of hard currency.

Lifting the ban on dollars opened up a free consumer market in the Cuban economy that had been sustained by price-control and rationing. The new market contributed to absorbing excess liquidity of the peso, and easing people's dissatisfaction with their poor consumption.

Stagnation of Economic Reforms

However, concerns grew among hardliners about the widening income disparity and growing black markets that had emerged after the commencement of economic reforms. In addition, the shooting down of small aircrafts, followed by the enactment of the Helms-Burton Act, heightened tension in U.S.-Cuban relations and accelerated the conservative mood in Cuba. As a result, economic reforms were stalled after 1996. Opening the *Paladares* became difficult, and levying income tax on self-employed businesses became stringent. As if it were to compete with the farmers' free markets, another type of market (*placitas de acopio*) was opened for agricultural products under a pricing system that the government controlled through subsidies. Foreign investment was also confined to roles "complementary" to the government's economic strategies. As a result, up to the year 2000, the government could report only one case of foreign investment that was funded 100% by foreign capital.

The stagnation of reforms is attributable to several factors. One is Mr. Castro's concern that individual initiatives under the market economy inflate egoism and widen the social divide. In fact, as the dual economy in pesos and dollars expanded, the income disparity grew wider between those who were employed by foreign-affiliated firms or export-oriented companies that had access to U.S. dollars, and those who worked in other types of enterprises, as well as most people in rural areas. According to government statistics, 60% of nationals have access to dollars (1999).

Another possible factor behind the stagnation was a sense of relief gained from the achievement of 7.8% economic growth in 1996 that led Cuban officials to believe that they had weathered the worst crisis. For Mr. Castro, the economic reform was nothing but a means for survival of the socialist regime, not a goal in itself.

Despite the retardation of economic reforms, it is unlikely that the government will repeal policies for improving efficiency through the strengthening of business actors' autonomy and inducing foreign capital. Now that generous assistance from the former USSR and Eastern Europe has stopped, there is no alternative for the Cuban government but to elevate the domestic saving rate and increase the intake of foreign capital in order to enhance the living standard. To raise the domestic saving rate, people must be motivated to work, and capital accumulation promoted. It is evident from the past history of Cuban socialism that inspiring people with socialist values alone is far from successful. On the other hand, in order to induce foreign investment into Cuba, it is essential to change the opaque process of investment approval, which is processed at the discretion of the top leaders. Otherwise, the entry of foreign capital will be stalled.

Future of Economic Reforms

The intention of the Cuban government not to reverse the economic reforms can be ascertained, for instance, by the fact that the SOE (state-owned enterprise) reform, which Cubans call *Perfeccionamiento Empresarial* (Enterprise Perfection), was commenced in 1998. The reform requires individual SOEs to become financially autonomous and to pay revenue tax in exchange for freedom of economic activity. The system is applied to corporations that have satisfied requirements such as the introduction of corporate accounting rules and the establishment of management transparency. Its objective is to strengthen efficiency in the management of SOEs that have posted huge losses, increasing the fiscal burden on the government. Through implementing this reform, the government intends, not to privatize corporations, but to reconstruct the socialist regime. The government insists that it is a way to draw socialism closer to a more perfect stage. Regardless of the rhetoric, however, the move of SOEs toward self-sufficiency will entail a need for market-based judgment in the interrelation among enterprises.

However, SOEs that have attained the *Perfeccionamiento Empresarial* thus far account for less than 2% of the whole. Moreover, foreign companies have been forced to enter Cuba as joint ventures with SOEs. There has been no increase in the number of self-employed businesses, either. Under such current conditions, it will be a long way before private or semi-private actors obtain sufficient political influence to affect the government's policies. Thus, control by the government is still effective. Whether economic reforms can move forward again depends both on economic conditions (economic difficulty will force reforms) and on decisions of political leaders.

2. Politics and Diplomacy

Political System

Like other communist countries, Cuba has adopted a "congressional system." The congress (equivalent to the Supreme Soviet of the former USSR) elected by the people is legally the supreme decision-making organ, with an executive body chosen by the congress being responsible for administration. In reality, however, the hierarchy of the communist party is placed in juxtaposition with governmental organs. The Politburo and Central Committee of the party control both the administrative and legislative branches of government.

The Cuban congress, called the National Assembly of People's Power, consists of 601 congressional members with 5-year terms. The congress normally meets only twice annually, for around two days each in July and December. During its adjournment, the Council of State composed of 31 members elected from among the congress members performs the role of a legislative body. Many of the members of the Council of Ministers, which is equivalent to the cabinet, are members of the Council of State and of the Politburo of the Communist Party. Thus, the power of Cuban politics is concentrated in a few leaders, headed by Mr. Fidel Castro who is the President of the Council of State and First Secretary of the Politburo of the Communist Party.

Amid the economic crisis after the 1980s, the Cuban Communist Party experienced demoralization and people's disillusionment, but after the 4th Communist Party Congress held in 1991, it renewed efforts to strengthen the party's influence. In particular, thanks to the active and continuous mobilization campaign by the UJC (*Unión de Jóvenes Comunistas*= Communist Youth Union) under new capable leadership, one out of ten citizens aged over 28 were registered with the party at the end of the 1990s.

Meanwhile, in the midst of the economic crisis, there appeared for a while some groups that were critical

of the current regime; six hard-liner groups formed the “*Alianza Democrática Cubana* (Cuban Democratic Alliance),” and eight moderate groups the “*Concertación Democrática Cubana* (Cuban Democratic Concert).” However, they have been hampered by stringent control by authorities as well as internal divisions and the exile of leaders. Therefore, it is not likely that any anti-governmental group will upset the current regime or grow to be powerful enough to replace it in the near future.

The emergence of anti-governmental groups, coupled with widening social divides and the growing number of self-employed businesses and private farmers, heightened the sense of crisis among Mr. Castro and other party leaders. As a result, the Cuban leadership recently commenced an ideological reinforcement campaign for people under the catchword of “*Batalla de Ideas* (Battle of Ideas).” Under this program, party leaders such as Raúl Castro appear at town meetings and on discussion panels on TV and radio, and sometimes discuss various themes with inhabitants.

Succession Issue

Mr. Castro is aged 75 at present and rumors that he is in poor health spread from time to time, arousing speculation about his successor. Those who are often named include Mr. Carlos Lage, Vice-President of the Council of State and reputed for his administrative talent, and Mr. Raúl Castro, the First Vice-President of the Council of State and the Minister of Revolutionary Armed Forces (FAR). What favors Mr. Raúl Castro for the successor position ranges from his rank in the party and his blood-relationship with his brother, Fidel, to the commander position he occupies in the FAR, a highly important organization that controls security forces under the Ministry of the Interior and manages successful dollar businesses. At any rate, unless the FAR experiences serious dissension, it is expected that the regime controlled by the Communist Party will escape an immediate collapse after Mr. Castro's retirement.

Relations with U.S.

Needless to say, the most important foreign party for Cuba is the United States. The revolution itself turned into a socialist regime through confrontations with the U.S., and subsequently the country maintained its regime in defiance to U.S. pressures. This posture of independence, we may say, is Mr. Castro's backbone.

During the Carter administration in the latter half of the 1970s, the strained relations between the two countries started to be eased. Nonetheless, unexpected incidents such as mass exiles, shooting down of small planes and the Elian González case have caused the repetition of regression and progress in the relationship between the two countries.

During the 1990s, the disappearance of the Russian threat from the Caribbean, concomitant with the Cuban policy to further open up to the external world, gave rise to a growing move within the U.S. government to ease its hostile policy toward Cuba. In 1998 and 1999, sanctions were partially eased; sales of foodstuffs and pharmaceuticals were further deregulated in October 2000. Though the Republican administration is generally believed to be tougher against the Castro regime, it approved the export of foodstuffs and pharmaceuticals for the first time in a sum equivalent to US\$30 million, to redress the damage caused by Hurricane Michelle, in November 2001. The Republicans also decided on a continuous freeze of Title 3 of the Helms-Burton Act that had been a symbol of U.S. sanctions against Cuba. (Under the Act, original owners of the confiscated assets may go to the court in the U.S. to recover the damages caused by the firms or individuals of a third country who have made investments using such ex-U.S. assets). In July 2001, a bill to deregulate American citizens' travel to Cuba passed the House of Representatives by a majority vote of 240 to 186. (The bill died due to the terrorist attacks on September 11, 2001, which deprived the Senate of

the time for deliberation.)

A major reason for the U.S. government's easing of its stance against Cuba is a change in the Cuban exile community. The death of the hard-line leader Mas Canosa led to an internal split in his organization, and a long-run generational change is under way. As a reflection of this, a sign of moderation is observed among the Cuban exiles. For instance, a large-scale poll conducted in 2000 by Florida International University indicates that on the one hand, over 60% favor the continuation of economic sanctions, but those who support the idea of having a Cuban exile as the post-Castro Cuban leader are in the minority (a bit over one quarter), while nearly half are of the opinion that the next leader should be a current resident of Cuba.

Generally, U.S. nationals other than Cuban exiles have little interest in Cuba. At present most people are not actively seeking the continuation of the economic sanction, but there is no pressure to lift it, either. Accordingly, the U.S. government is unlikely to remove the sanctions as long as strong opposition from Cuban exiles can affect elections in important states. In the meantime, however, when the U.S. government transferred Al-Qaida soldiers to the Guantanamo base, it showed consideration for the Cuban government by providing prior notice, and Cuba acknowledged this calmly. In sum, although the future path could be affected by the personality of officials in charge of Cuban policy in the U.S. government, relations between the two countries are expected to improve gradually.

Relations with Europe and Japan

Canada and European countries have adopted a policy of promoting economic liberalization and democratization of Cuba through deepening of their relations with the island country. EU countries tried to link their economic cooperation to democratization and human-rights protection under their policy called "Critical Dialogue," while Canada tried likewise under the "Policy of Constructive Engagement." Realizing, however, that their policy of making economic cooperation conditional on democratization and the protection of human rights does not bring an immediate result, both have now shifted to longer-range engagement policies. Led by Spanish firms, European and Canadian companies have also made active entries in sectors such as tourism, mining, port facilities, and cement manufacturing.

Japan has recently taken an attitude similar to that of Europe and Canada. In 1998, a policy dialogue was commenced between high officials in the ministries of foreign affairs of Japan and Cuba. In 1999, a delegation of 8 members of the House of Representatives headed by the Representative Mitsuzuka and a larger group of business people visited Cuba and agreed on the long-pending issue of rescheduling short-term public debts. This was followed by many other mutual visits by high officials and congressional leaders of both countries. In October 2001, Mr. Hashimoto, ex-Prime Minister, visited Cuba.

In 1997, both governments agreed on grassroots project grants and have thus far carried out more than 10 projects in humanitarian fields. Under various technical-cooperation schemes, dispatch of experts and acceptance of trainees have also been implemented. In addition, in 1999, JICA conducted a Project Formulation Study in the environmental sector, and started the "Havana Bay Purification Project." In October 2000, JICA sent its first Project Identification Mission to Cuba, which conducted detailed discussions with Cuban officials about technical cooperation in the future. In June 2001, JICA carried out a Project Formulation Study in the agriculture sector, and since last August it has stationed a long-term Project Formulation Advisor in the country. Since Cuba is in a state of moratorium on medium- and long-term debts and thus in a difficult position to obtain concession loans, Japanese ODA to Cuba is still limited in comparison with that to other countries equivalent to Cuba in terms of national income. Nevertheless, it seems to be certain that the relation between the two countries will grow in the future.

The year 2002 marks the centennial of the first contact in modern ages between Japan and Cuba. Upon the independence of Cuba, President Estrada Palma sent a letter to Emperor Meiji notifying him of Cuba's independence and his own inauguration as President, and the Emperor answered with a letter wishing for the development of a friendly relationship. The Japanese Embassy in Cuba is preparing various events in this commemorative year.

3. Economic and Social Conditions

Hard Currency Bottleneck

The present structure of the Cuban economy is characterized by a hard currency bottleneck and dual economy. Even under the socialist regime, the country has hardly overcome an economic structure relying on exports of natural resources such as sugar and nickel. Because of this, Cuba remains underdeveloped, a status symbolized by its high import elasticity and lack of stable export revenues. Reflecting Cuba's weakness in the areas of basic foodstuffs and manufacturing, growth in GDP leads to the expansion of imports many times as large as the GDP growth, causing frequent deterioration in the country's balance of trade. In many developing countries, a capital account balance alleviates the trade deficit. However, because Cuba is not a member of the International Monetary Fund (IMF) or World Bank, and many of its external debts still remain in a state of moratorium, Cuba is unlikely to have much inflow of new money, in particular medium- or long-term funds. Premiums for short-term borrowing are also extremely high for Cuba. As a result, the shortage of hard currency deters investment and production in all areas of the Cuban economy.

Inviting more foreign businesses to the country is one way of improving this situation. However, for political and ideological reasons, the Cuban government is willing to accept only selected companies. Moreover, the dual economy system, as described below, makes foreign businesses hesitant to enter the Cuban market. Even if foreign capital does move into Cuba, much of it is invested in areas in which Cuba remains internationally competitive, for example in the traditional export sector of natural resources such as nickel, and in tourism. Investment in these sectors does not help to reduce the import of food and manufactured goods.

In light of such insufficiency in foreign borrowing and direct investment, Cuba will inevitably rely for hard currency income on its traditional exports of natural resources and on tourism, as well as on remittances from Cubans in the U.S. As sources of hard currency revenue, however, these are without exception unstable. A devastating hurricane or an unexpected incident such as an act of terrorism could aggravate the hard currency bottleneck quickly.

Structure of Dual Economy

The dual structure of the Cuban economy means that two types of economy coexist: the peso economy, based on price control and rationing, and the dollar economy where relatively free transaction is allowed. The peso sector produces goods and services for the domestic market under central planning and control and specifically includes agriculture (including sugar), the government sector, education, the health and medical service sector, and pensioners. Since prices are controlled in these sectors, firms and other operational entities are unable to continue operations without subsidies or price-differential compensation from the government. Workers and pensioners receive monthly allowances as well as assistance in the form of rationing of foodstuffs. Education and medical care are provided free of charge. Government expenditures in 2000 for education, medical care and social security accounted for 37% of the whole, and subsidies for SOEs and UBPCs (Basic

Units of Cooperative Production) amounted to 19%, while government investment remained at 11%, a figure equivalent to only 6.3% of GDP. This is the reason for the serious shortage of investment in Cuba, where the private sector is small.

The dollar economy supports the peso economy. The actual supporters are firms and their employees in such sectors (including stores and restaurants belonging to the tourism sector) that produce tradable goods and services in the broad sense of the term. Foreign-affiliated companies naturally fall into this category, while many SOEs that have attained the "*Perfeccionamiento Empresarial*" are also included in the dollar economy. These firms purchase input materials freely in dollars, and sell products and services in quality and at prices according to international standards. Employees working at these firms receive wages partly in dollars or in convertible pesos (peso guaranteed for exchange at one peso to one dollar), or in kind with goods which are sold at dollar-shops. They can afford to buy goods at dollar-shops or in free markets, but when they convert the peso portion of the wages into dollars, they are forced to convert at the going exchange rate of 1 dollar to 27 pesos (as of the end of February, 2002).

Firms, their employees and self-employed businesses belonging to the dollar economy support the government treasury. Firms with no earnings are exempted from the revenue tax and worker-use tax. Therefore, taxes are levied mostly on foreign-affiliated firms and a small portion of the SOEs, which have attained "*Perfeccionamiento Empresarial*." Moreover, while those who receive wages in pesos and pensions are free of income tax, self-employed businesses are not. In 2000, 150,000-plus self-employed business proprietors, equivalent to only 4% of the total working population, accounted for 90% of total taxpayers.

Delay in Investment in Physical and Human Capital, and Environmental Deterioration

Broadly speaking, we can conclude from the foregoing argument that the peso economy of Cuba is supported by hard currency earned by its dollar economy. Nevertheless, the Cuban government continues to accept only selected foreign investors, and to control the growth of self-employed businesses. As a result, government revenue remains minimal in growth, and annual expenditure has to be controlled accordingly. The result is a reduction in investment by the government. This has caused not only delays in developing infrastructure such as roads, energy and irrigation facilities, but also reduction in government spending in areas such as education, culture, arts and sports, which have been a traditional forte of Cuba. As seen in the fact that the gross enrollment ratio in higher education fell from 21% in 1989-90 to 12% in 1998-99, the government seems to be maintaining a policy of sustaining the living standard of the unemployed, surplus workers in the state sector and pensioners at the cost of investment in physical and human capital. It is strongly feared that such a policy will create an additional bottleneck for economic growth in the future.

The fiscal weakness of the government also makes it difficult to spend funds to keep the environment from deteriorating. In the past, socialist regimes that attached greater importance to increasing production tended to slight environmental issues. On top of that, the growth of civil society has been retarded under the undemocratic government, which has impeded the growth of concerted action by residents for environmental improvement. As a result, in urban areas, wastes and fouled sewage have polluted the soil, rivers and the sea, while in rural areas, soil deterioration such as high salinity levels, and water shortages, have become critical issues. Furthermore, in the environs of nickel mines located in the northeastern part of the country, waste liquid has polluted rivers and shores, and along the northern seacoast, the effluence of crude oil out of subsea drilled oil wells has spread oceanic pollution. Havana Bay, turbid in dark brown color, symbolizes the gravity of Cuba's environmental problems. Now, the situation could hurt the tourist industry that is an important moneymaker for Cuba.

Chapter 2 Direction and Challenges of Medium-term Development of Cuba

1. Basic Perspectives

Unavoidability of Economic Reforms

To understand Cuba, it is not sufficient to study only the period from the revolution through the present. One should also pay attention to its economic structure, which was created during the period ranging from the era of Spanish colonialism to the early years of independence. The post-1959 revolutionary government has failed to change the fragile economic structure, which is reliant on the development and export of a few primary products including sugar. This has underlain the state of underdevelopment of the Cuban economy to date.

This economic fragility surfaced upon the termination of assistance from the former USSR and Eastern Europe, and thus, a series of economic reforms that can potentially lead to a de facto “transition to a market economy” was started in 1990. These reforms, however, have just started as compared with the progress made by other transition economies, and are faced with serious problems such as the fragility of the industrial structure and inefficiency of the economic system. The rigid dual exchange-rate system, fiscal problems such as a huge amount of subsidies and the immaturity of the tax system, and the underdevelopment of financial policy tools – these are all challenges in macroeconomic management. Furthermore, inefficiency of SOEs and the agricultural sector due to poor incentive structure, and the lagging financial sector that can hardly perform a financial intermediary function – many of these issues remain to be solved.

Meanwhile, as seen in the introduction of the “*Perfeccionamiento* (Perfection)” policy for SOEs, government officials increasingly recognize the inefficiency of economic institutions under the planned economy. Still, the main object of economic reforms for the nucleus of Cuban political leaders is the survival of the socialist regime, and therefore, they have imposed restrictions on activities and development of foreign companies and self-employed businesses.

Supremacy of Politics over Economy

The Cuban system is characterized by a close linkage between politics and the economy. Fundamentally, there is a supremacy of politics and ideology for maintaining the on-going regime. This underlies the economic system. Nonetheless, when a serious economic crisis or difficulty arises, the economic conditions will make an impact upon politics and create an incentive for economic reforms. As a result, voices for a policy in favor of liberalization that could eventually mean “transition toward a market economy” become louder. However, when the economy recovers as a result of economic reforms, or of the recovery of the international prices of primary products, conservatives who advocate adherence to the current regime come to the fore. Then, the economic-reform line will be toned down. This pendulum coexists with economic fluctuations.

Cuba is expected to enter a period of sluggish economy again in the near future due to changes in the international economic environment after 2001, which include the downturn of international prices for Cuba's major primary exports (sugar, nickel, etc.), the rise in the import price of oil, the global economic slowdown, and the September 11 terrorist attacks, causing drastic reduction both in tourists and in remittances from abroad. Accordingly, along with the recognition of the inefficiency of the economic system, as described above, we expect that momentum for continuous economic reforms will be generated in the future.

Meanwhile, a trend toward a society tolerant of the coexistence of diversified values is glimpsed in the activities of church groups and human-rights groups. This transformation is still weak and carries no potential yet to influence the political trend or economic policy of Cuba in the near future, but if the de facto transition toward a market economy continues, this change is expected to accelerate, along with the increased autonomy of firms and other entities and the growth of self-employed businesses and private farmers.

However, as the leader of the Revolution and the national leader since the Revolution, Mr. Fidel Castro keeps power firmly in his hand. As long as he takes the helm of state affairs, there will be no drastic change in the current socialist system. Moreover, since there exists no other party that can take over the government, and the military is satisfied with the status quo through its successful business involvement, the current centralized regime will persist after the retirement of Mr. Castro. In short, it will be appropriate to assume the continuation of the current regime when we examine the future direction of Cuba's development.

Problems Associated with Economic Reforms

Problems to be tackled together with economic reforms include the revision of social policies and environmental issues. Under economic crisis, social services for the people declined both in quantity and quality. Nonetheless, the expenditure for services is still too large for Cuba's economic capability and is one of the factors pressing on the government's coffers. Consequently, as a part of economic reforms, a comprehensive review of social policies is essential. However, since the current regime emphasizes equality and social welfare of the people to strengthen its legitimacy, and also because such state services are taken for granted by the people at large, we fear that the dismantling of on-going social policy may cause social and political disorder. Due attention should be paid to the balance between economic reforms for future growth and the provision of welfare services to maintain social stability.

Environmental problems, which predated economic reforms, were aggravated under the economic crisis since 1989. One might argue that environmental protection should be put off to give priority to economic recovery. In the case of Cuba, however, environmental deterioration has gone too far. Unless environmental problems are solved, there will be no economic recovery. For example, marine pollution is threatening the tourist industry, and soil deterioration is undermining agricultural production. Economic reforms in the future will have to be handled hand in hand with the tackling of environmental problems.

2. Preferable Direction of Development

Gradual Reforms

As mentioned in the preceding paragraphs, under the circumstances in which the necessity for continuous economic reforms is recognized and a movement toward the acceptance of plural values is germinating, it is important for Cuba to advance to a "soft landing to a market economy and democracy coexistent with social fairness." In such advancement, the practical approach for Cuba will be to take measures for a gradual transition toward a market economy and move forward steadily just as socialist countries like Vietnam, China and Uzbekistan have done. That is to say, under the current regime, promoting reforms at a relatively slow speed with proper attention paid to the sequence seems to be preferable to pursuing a number of reforms hastily and simultaneously. The gradual approach will help avoid the political cost of a clash between reformists and conservatives.

Although economic reforms by themselves do not bring about democratization automatically, actors

autonomous from the state who will grow in number out of economic reforms are expected to help the country move forward to political reform, liberation and democratization in the long run.

Advancement of Economic Reforms

For achieving medium- and long-term economic growth in Cuba, diversification of the industrial structure and enhancement of efficiency in the economic system are vital requirements. For that purpose, the current economic reforms for the de facto transition to a market economy need to be advanced further. Since additional investment is essential for diversification of the industrial structure, domestic savings should be mobilized through expansion of the scope of activities of self-employed businesses and private farming. Increased acceptance of external savings, namely, foreign direct investment, is also necessary. In this respect, it is required to create an environment that is attractive for foreign enterprises. The creation of such an environment needs (i) formalizing transparent criteria for approving investment, (ii) removing regulations that remain in areas such as employment, acquisition of real estate, and sales of goods, and (iii) creating market infrastructure in terms of both soft and hard components. The entry of foreign firms is of great significance since it provides Cuba with valuable foreign funds together with efficient transfer of additional factors such as the latest technologies and management resources.

At the same time, in order to facilitate borrowing from overseas, it is necessary for Cuba to seek membership in international financial institutions such as the IMF, World Bank and Inter-American Development Bank (IDB).

Furthermore, the reform of SOEs and fiscal reforms that are strongly linked thereto cannot be achieved without a reform of the pricing mechanism (i.e. elimination of the dual economy). Improvement in productive efficiency of SOEs necessitates further advancement of market-oriented reforms (i.e. the expansion of autonomous management together with the imposition of hard budget constraint, etc.).

Improvement of Legal System and Governance

The reorganization and improvement of administrative and legislative functions, namely the enhancement of governance, are also indispensable for the promotion of a market economy. While it will be necessary to maintain consistency among a wide range of political and economic policies and to consider the sequence of gradual progress, the promotion of reforms requires high administrative competence as well as enthusiasm for reforms. Currently, however, there are many problems with the efficiency of the bureaucratic mechanism as weighed against the number of ministries and agencies and the number of personnel. Administrative reform accompanied by strengthening of human resources is one of the keys to a successful soft landing to a market economy and democracy.

In order to succeed in economic reforms, it is required to establish appropriate legal frameworks and institutions concerning economic activities and tax liabilities, and to create clear and transparent market rules (such as standards and regulations). Other requirements for reforms include (i) analysis of the cost-benefit distribution between sectors and between groups, (ii) compensation for groups that are harmed by reforms, (iii) steps to enhance transparency of the reform process (in order to earn the people's understanding and confidence in reforms), and (iv) education about the necessity for reforms.

Furthermore, the diversification of economic activities and actors and the reorganization of social services will make centralized control difficult. Consequently, it will become necessary to decentralize the governmental functions and increase the capabilities of local governments. Fostering local human resources will, in turn, lead to correcting excessive centralization of power and thus will contribute to promoting democratization.

Consideration of Social and Environmental Problems

As described above, Cuba will not be able to avoid reforms in social policy to provide “sustainable” social services (education, health, social security, etc.) matching the economic capacity and conditions of Cuba, while maintaining a minimal social safety net. Cuba also needs to tackle environmental problems which have been slighted under the planned economy system.

3. Major Development Challenges for Cuba

Cuba faces various challenges to achieve a “soft landing to a market economy and democracy coexistent with social fairness.” These challenges require a certain extent of time and unfailing efforts. Yet, if the country continues indefinitely to maintain its inefficient economy and repressive political system as they are, the soft landing may never happen. Therefore, the development of Cuba must be explored in medium-term perspectives. The issues that are considered of high priority for Cuba are summarized as follows.

(1) Further Transition to a Market Economy

- Removal of the price control system and the unification of dual exchange rates are indispensable to put an end to the dual economy that is impeding an efficient distribution of resources and deterring economic activities of private businesses.
- Employment should be increased by expanding the scope of activities of non-state sectors such as self-employed businesses and private farming, which would shift the excessive manpower of the inefficient peso economy to more productive sectors.
- Tax reforms will energize business activities. Simultaneously, on the expenditure side, sound fiscal standing should be established by a review of subsidies to SOEs and universal social security spending.
- The reform of SOEs should be promoted to improve the efficiency of the economy as a whole. The introduction of new technologies and the renovation of facilities are also vital to improve productivity and to reduce the environmental cost.

(2) Industrial Promotion

- Transparent procedures for accepting foreign firms should be established and such firms should be actively invited to participate in sectors which have a high capacity for earning hard currency, such as tourism, sugar, mining, tobacco, fishery and biotechnology.
- Other manufacturing industries and agriculture may not always be attractive to foreign firms. Therefore, domestic entities such as SOEs and self-employed businesses should develop those sectors. In order to make the most of limited governmental resources, it is desirable to conduct a detailed industrial survey as to what fields are suitable for importing, and in what fields domestic production should concentrate; and to formulate medium- and long-term development plans.
- Cuba’s strained foreign-reserve status can be partly alleviated by agricultural diversification and the introduction of productivity-improving agro-technologies. Cuba has been unable to emerge from its structure of monocultural agriculture specializing in sugar, and 60% of the staple food, i.e. rice, has to be imported at the moment.
- More electric power should be supplied to develop local industries and improve people’s quality of life, particularly in rural areas. Although Cuba is seeking to increase domestic production of energy sources

such as oil and natural gas, the power supply is not sufficient yet. It is recommended to introduce energy production technologies and facilities, low in cost and environmentally friendly, and to develop and utilize alternative energy such as natural gas and biomass.

(3) Improvement of Governance

- In order to strengthen administrative capacity and to ensure transparency of the reform process simultaneously, it is required to reform ministries and agencies, improve the civil service system, establish firm disciplines and norms for administrative operations, and to make efforts for public disclosure of information.
- Laws and institutions for promoting the market economy should be enhanced. Specifically, it is important to improve the econo-judicial system as well as economy-related legislation, and to expand the capacity of judicial institutions including courts.
- Geographical decentralization and intra-organizational decentralization of the government should be advanced. It is also necessary to improve the capacity of administrative officials at provincial and municipal levels, and of senior officials of various types of organizations.

(4) Implementation of a Sustainable Social Policy

- A tax system that balances economic growth and social equity should be established.
- In order to minimize social stresses arising from the transition to a market economy, a good safety net should be provided for the weak in the market. At the same time, the current system of universal social services should be revised to lessen the fiscal burden.
- A considerable achievement in the past in public health, medical services and education should be maintained through efforts to restructure and/or strengthen the facilities that have deteriorated in the years of economic crises.
- The water-supply facilities as a whole need improvement; Cuba is endowed with water resources to meet demand, but more than half of waterworks are dated 1970s-1980s and they have been degenerating. Moreover, since access to running water in rural areas is very limited (38% as of 1997), expansion of the water supply is essential.

(5) Environmental Protection

- Critical water pollution has been caused by industrial effluent and household wastewater in urban areas. In particular, the contamination of Havana Bay is a most serious problem. In light of the fact that it is threatening people's health and tourism, with an adverse effect on neighboring Caribbean countries, immediate steps must be taken to tackle this problem.
- In rural areas, soil degeneration such as soil washout, acidification, and salinization has been aggravated. Prompt countermeasures should be taken to restore agricultural production.
- Additional problems such as waste disposal, factory gas emission, and air pollution caused by secondhand cars require the creation of a monitoring system and the strengthening of legal regulations.

Chapter 3 Proper Approach for Japan's ODA to Cuba (Policy Recommendations)

1. Significance of Expanding ODA for Cuba

Cuba as an “Underdeveloped Country”

Cuba is an underdeveloped country with a fragile industrial structure similar to the one that existed prior to the revolution, with per capita disposable income a little less than US\$100 annually. The social safety net providing people with rationed basic food and free medical service and education serves somewhat to improve the living standard of the people at large. Nonetheless, Cubans are in severe economic distress. Since the termination of assistance from the USSR and Eastern Europe, the country has been suffering a keen shortage of hard currency. The government is barely covering its running cost, and thus, they are unable to match sufficient funds for investment in infrastructure or facilities to raise productivity. Therefore, Cuba should be first treated as a typical underdeveloped country, rather than as a socialist country, that is entitled to ODA from developed countries.

Nevertheless, Japan's ODA for Cuba remains small in amount. This is not because Cuba is a socialist country whose record on human rights and democracy is poor. Japan has been expanding ODA for China and Vietnam, both of which are in similar standing in this respect. The reason why Japanese ODA to Cuba has been limited is that the US, which is Japan's most important ally, has had no diplomatic relations with Cuba, and has exercised economic sanctions against it. Japan has been hesitant to adopt a policy that runs counter to the intention of the U.S. government in the de facto U.S. sphere of influence.

Internal Changes in the U.S., and Its Long-term Interests

However, along with the decline of anti-Cuban hard-liners in the U.S., the situation has changed to the extent that it is no longer likely that the U.S. will oppose Japan even if this country expands its ODA to Cuba, unless the assistance is of the kind that directly strengthens the Castro regime, or affects former U.S. assets.

With the disinterest of the American people at large, and a vocal political opposition that influences elections in certain important states, it is not conceivable that the U.S. will move toward complete removal of sanctions in the near future. As stated previously, however, due to the death of the hard-line leader, Mas Canosa, and the generational transition in the Cuban American community, the community is becoming more moderate. Moreover, private firms in agricultural and pharmaceutical industries are also desirous of reopening business with Cuba. Their representatives have frequently visited Cuba in recent years. In November 2001, the export of foods and pharmaceuticals to Cuba, equivalent to \$30 millions, was authorized, which the U.S. government approved under the pretext of humanitarian assistance to redress the damage caused by Hurricane Michelle. It attracted public attention as the first large-scale U.S.-Cuban trade since the commencement of sanctions.

In light of the aging of Mr. Castro, issues concerning post-Castro uncertainty deserve serious consideration. In this respect, it is desirable even for the U.S. for Cuba to make a soft landing toward political and economic liberalization without falling into disorder. Should a civil war break out, a flood of refugees will certainly become a serious problem for the U.S. Furthermore, should some groups of Cuban Americans take up arms and attack Cuba, the U.S. government will face an awkward and difficult situation. Therefore, ODA that helps Cuba make a soft landing to a market economy and democracy in the long run should be beneficial to the

U.S. Japan and European countries can play a significant role by taking the place of the U.S. government, whose hands are tied by numerically small but vocal opposition groups, and by prompting Cuba to make a transition to a market economy and social pluralism.

Benefits for Japan

The expansion of Japanese ODA to Cuba will bring positive benefits to Japan itself. First, the assistance that is instrumental in helping the move toward a market economy and democracy meets the principles of the ODA Charter that Japan has manifested to the world as part of its contribution to global issues.

Second, if Japan succeeds in inducing Cuba to make a “soft landing to a market economy and democracy coexistent with social fairness,” the tense relations between the U.S. and Cuba will be eased, and the potential risk of disturbance in the Caribbean will be lessened. This will be an important contribution to Japan’s economy that depends on the Panama Canal for the transportation of many important goods.

The third significance lies in the protection of as many as 700 people of Japanese descent. Should Cuba fail to make a gradual transition and fall into disturbance, their lives and property could well be exposed to danger.

Fourth, the economic potential of Cuba is attractive to Japanese companies. Cuba is similar to Asian countries in that its workers are disciplined and well educated. Moreover, its domestic market remains to be explored. There is a chance that export-oriented manufacturing industries will grow considerably in Cuba, once the U.S. market is opened.

Finally, in order for both the Japanese government and private companies to recover loans to Cuba, it is desirable for Cuba to follow the right track toward stable economic growth. In March 1998, private loans in an amount of \$769 million were rescheduled, and in January 2000, repayment of short-term public debts in a sum of 12.0 billion yen was deferred. These debts remain unstable and could fall again any time into a state of moratorium. Medium- and long-term public debts of 73.0 billion yen have not been dealt with at all.

Development Model for Developing Countries

In addition, Cuba’s reform is important because it can be a model of economic reform for other developing countries including those in Asia. Though advanced in economic reforms, Latin American countries (other than Cuba) implemented reforms so quickly and so broadly that they lost control over the widening of social polarization, which in turn caused outbursts of crimes and disorder. To prevent such social dislocation, economic liberalization and deregulations need to be addressed hand in hand with the provision of a social safety net. Cuba, which adheres to the principal of social fairness, can provide a test case for such deliberate reforms. At the same time, in the process of moving toward a mixed economy (in which the government, while keeping controls, permits private entities to expand their domain), corruption is likely to flourish, as widely observed in China. Cuba can be a test case for preventing corruption.

2. Basic Policy for Japan’s ODA to Cuba

Based on the previous discussion, the Study Committee recommends that the following should be Japan’s basic ODA policy for Cuba from the medium-term perspective covering the next five years.

(1) Proper Approach for Japan's Assistance to Cuba

- 1) In order to avert needless friction with the U.S. government, Japan should avoid the kind of projects that might directly strengthen the current Cuban regime, or projects that involve former assets of U.S. citizens or corporations. To avert the latter risk, a careful investigation is required before formulating cooperation projects.
- 2) Japan should give priority to assistance that can help Cuba effectively handle development challenges in the course of its making a "soft landing to a market economy and democracy coexistent with social fairness." Projects to be given high priority include (i) helping improve the living condition of the Cuban people, (ii) assisting Cuba's effort for political and economic liberalization (i.e. creation of diverse interests in society) in the long run, and (iii) assisting Cuba's policy for the socially weak so that they will not be left behind with little governmental service in the process of the current economic reforms.
- 3) In the implementation stage, the Japanese government should explore opportunities: (i) to tie up with other donors in technical cooperation with Cuba; (ii) to help Cuba obtain access to fresh loans from abroad; (iii) to utilize international and regional frameworks for cooperation. It is desirable for Japan to take advantage of the occasions of policy consultations to explore the possibility of Cuba's participation in international financial institutions such as the IMF, World Bank and IDB. Japan can also propose that Cuba join regional cooperation mechanisms such as the Caribbean Disaster Emergency Response Agency (CDERA), so that Cuba can share the benefits of regional economic and human development projects, including disaster prevention.
- 4) Japan should also consider the possibility of involving Cuba with its human resources as Japan's partner in ODA projects for Latin America and Caribbean countries. South-South cooperation and/or Tripartite cooperation can be pursued in fields in which Cuba has a comparative advantage (medical service, in particular).

(2) Principal Issues in Japan's Assistance to Cuba

The following issues should be emphasized in Japan's assistance to Cuba.

- 1) Promote sustainable development of Cuba as an "underdeveloped country"

Environmental protection and other measures

- Technical assistance for countermeasures against water pollution of the sea and rivers in urban areas, in particular for Havana Bay purification
- Technical assistance for countermeasures against soil deterioration in agricultural areas

Increase food production

- Technical assistance for increasing basic food production, including the strengthening of the irrigation and drain system. Assistance should be provided preferentially to farms located in areas with a good record of productivity. Since the average land productivity of imported rice is twice as high as that of domestic rice, technical assistance for low-productivity areas/farms would be wasteful.

Strengthen infrastructure for living environment

- Policy and/or technical advice to strengthen the infrastructure for the living environment. In particular, infrastructures such as water supply and electrification need to be improved in rural areas that are lagging behind in development.

- 2) Assist Cuba's effort to promote political and economic liberalization (leading to the creation of diverse interests) in the long run, so that the country can make a "soft landing to a market economy and democracy coexistent with social fairness."

Promote economic reforms

- Assistance for reforming systems of public service, finance, taxes, etc. In particular, capacity building of middle-level officials is important. In these areas, it is required to avoid duplication of projects by coordinating with EU countries, Canada and U.N. agencies that have experience in these fields in Cuba.
- Assistance for SOEs' reform: support for acquiring skills and know-how to improve efficiency. For instance, training for improvement of quality and productivity and assistance for strengthening diagnostic capability such as the functions conducted at the CEFOF (Productivity Training Center) in Costa Rica can be useful. Utilizing these existing functions, promoting participation in Third-country training programs (training courses conducted in other developing countries) of the region and establishing country-focused training programs (tailor-made training courses organized for a single country) in Japan are all desirable. With regard to assistance in SOE reforms, careful attention should be paid to the selection of projects, since some SOEs are run by the military. The assistance should not go counter to democratization.

Raise awareness and capability of middle-level officials in provincial and municipal governments, functional units and the national government

- Assistance for capacity building of local governments. Japan should foster autonomous capacity of provincial and municipal officials, especially in cooperation with UNDP, which is taking the lead in this field.
- Capacity building of middle-level officials in sectoral and issue-oriented working groups such as agriculture cooperatives and the National Working Group for Sanitation, Conservation and Development for Havana Bay.

- 3) Cooperate to prevent deterioration of social conditions under economic reforms in progress

Improve social policy

- Assistance for policy review for improving the system of social safety net, focusing on health, medical care and education. This assistance is significant from the humanitarian point of view.

- 4) Utilize Cuba's human resources in Japan's ODA programs and help the Cubans participate deeper in the international community.

Promote South-South cooperation and Tripartite cooperation

- South-South cooperation should be explored in fields in which Japan has limited human resources. Cuba is endowed with relatively rich human resources in certain fields including medical service. In this regard, Cuba, with Japanese assistance, can dispatch its nationals with medical expertise to countries in the neighboring region. Tripartite cooperation should also be considered. For example, Cuba can dispatch medical doctors to neighboring countries to complement Japan's assistance in supplying medical equipment.

Matrix: Current Status and Development Challenges of Cuba, and Recommended Approach for Japan's ODA

Category	Current Status and Problems	Direction and Challenges for Cuba's Development Preferable Direction of Development Soft landing to a market economy and democracy coexistent with social fairness Cuba's Major Development Challenges:	International Assistance to Cuba (Major Assistance by Other Aid Donors)	Principal Issues for Japan's Assistance 1) Promote sustainable development of Cuba as an "underdeveloped country" 2) Assist Cuba's effort for political and economic liberalization in the long run 3) Cooperate to prevent deterioration of social conditions under economic reforms in progress 4) Involve Cuba with its human resources as Japan's partner in ODA projects	Notes regarding Implementation of Japan's Assistance
Transition to a Market Economy	<p>Foreign currency bottleneck</p> <ul style="list-style-type: none"> Economy: unable to move away from underdeveloped state (export dependent on a few primary products (sugar, nickel, etc.), high import elasticity) Difficult to raise overseas funds due to no membership in international development financial institutions, past external debts still in moratorium Selective about FDI (for political reasons) Additional foreign currency revenues (mainly income on tourism and remittances from overseas) vulnerable to climate and unexpected incidents <p>Structure of dual economy</p> <ul style="list-style-type: none"> Dollar economy sector supports peso economy of domestic market Government revenues mainly provided by the dollar economy sector Firms/entities in peso economy need subsidies Consequently, government investment extremely limited <p>Launching SOEs reform, i.e., Perfeccionamiento Empresarial</p> <ul style="list-style-type: none"> In 1998 commenced "Perfeccionamiento Empresarial," aiming at financially autonomous SOE operations But only 2% of SOEs have achieved "Perfeccionamiento" to date Difficulty in establishing proper corporate accounting as well as pervasive socialist mentality among managers and employees: hurdles for achieving "Perfeccionamiento" <p>Delay of investment in physical/ human resources</p> <ul style="list-style-type: none"> Insufficient investment feared to hamper future economic growth 	<p>(1) Further Transition to a Market Economy</p> <ul style="list-style-type: none"> Securing effectiveness of financial and fiscal policies by reforming macroeconomic management, i.e., removal of price controls and unification of dual exchange rates Expanding scope of private businesses such as self-employed businesses and individual farmers, to increase employment Tax reform to energize business activities Reviewing/removing subsidies to SOEs and universal social security expenditures to stabilize state's fiscal standing Further SOE reform Inducing foreign direct investment, and joining international financial institutions <p>(2) Industrial Promotion</p> <ul style="list-style-type: none"> Making transparent investment procedures to induce FDI Formulating medium- and long-term development plans based on detailed industrial surveys that cover viability of knowledge- and technology-intensive industries and support to small- and medium-sized manufacturing enterprises Agricultural diversification and enhancement of agro-technologies Expansion of power supply Introducing and innovating new technologies 	<ul style="list-style-type: none"> Canada: improving tax administration, providing training on economic management, statistics, etc., and reforming industrial sector (assistance for acquiring ISO certifications) UNDP: reforming Central Bank organizations and improving macroeconomic management EU: reforming financial sector and SOEs Spain, Netherlands, Germany, Uruguay, U.K., France, etc.: assisting the Central Bank Germany, U.K., Spain, etc.: assisting the Ministry of Finance and Prices 	<p>Promote economic reforms 2)</p> <ul style="list-style-type: none"> Assistance for reforming systems of public service, finance and taxes, particularly capacity building of middle-level officials <p>• Assistance for SOEs' reform: support for acquiring skills and know-how for improving efficiency</p>	<ul style="list-style-type: none"> Coordinate activities with other donors that have experience in this field Caution needed about connections with military sector (e.g. enterprises run by the military) Utilize existing functions such as CEFOF in Costa Rica
Governance	<p>Current regime to continue for the present</p> <ul style="list-style-type: none"> Power concentrated in a limited number of leaders headed by Mr. Castro Implementing reinforcement of the power through ideological enhancement campaign Communist party expected to maintain control for the time being after Mr. Castro's retirement A sign of improvement in Cuba's relations with the U.S. favorable for sustaining the current regime for some time Meanwhile, trends of increasing pluralism seen sporadically (such as church-group activities, human-rights-group activities) <p>Strengthening legal and judicial system and improving governance to support economic reforms</p> <ul style="list-style-type: none"> Improvement of governance essential to support economic reforms to result from economic slowdown after 2001 	<p>(3) Improvement of Governance</p> <ul style="list-style-type: none"> Strengthening administrative capacity through reforming ministries/agencies and improving civil service system Efforts for public disclosure of information to ensure transparency of reform processes Enhancing econo-judicial system and strengthening economy-related legislation, including clarification of market rules Increasing capacity of judicial institutions Improvement of economic statistics Regional decentralization and intra-organizational decentralization to support diversified economic activities Capacity building of local administrators and officials of issue-oriented working groups such as the National Working Group for Sanitation, Conservation and Development for Havana Bay 	<ul style="list-style-type: none"> Canada: assisting decentralization through providing distance education, and improving public management system UNDP: strengthening administrative capacity of local governments 	<p>Raise awareness and capability of middle-level officials at provincial and municipal governments, functional units and national government 2)</p> <ul style="list-style-type: none"> Foster autonomous capacity of local government officials <p>• Capacity-building of sectoral and issue-oriented working groups, such as agriculture cooperatives and the Havana Bay purification working group</p>	<ul style="list-style-type: none"> Strong cooperation/tie-up needed with other donors
Social and Environmental Issues	<p>Social policy</p> <ul style="list-style-type: none"> Excessive government spending beyond its capacity exerting fiscal pressure People take current social services for granted Income disparity on the increase recently Insufficiency of facilities and school supplies and lack of quality education at tertiary level Aged facilities, shortage of equipment and pharmaceuticals in the medical sector Consideration for the socially weak necessary under economic reforms in progress <p>Environmental measures</p> <ul style="list-style-type: none"> High priority given to restoration of severely deteriorated environment for economic recovery Soil deterioration, deforestation: main problems categorized as "green" Water pollution (especially in the Havana Bay), air pollution and municipal waste: problems as "brown" Necessity to strengthen administrative and executive capacity of CITMA (Ministry of Environment) Community participation essential in environmental management 	<p>(4) Implementation of Sustainable Social Policy</p> <ul style="list-style-type: none"> Establishing tax system, balancing between economic growth and social equity (in implementing reforms while avoiding social or political instability) Creating mechanism to provide "sustainable" social services (education, health, social security, etc.) Restructuring and strengthening facilities for health and medical services and education Providing a minimal safety net Improving and expanding water supply facilities, especially to rural areas <p>(5) Environmental Protection</p> <ul style="list-style-type: none"> Countermeasures against water pollution, particularly in the Havana Bay Countermeasures against soil deterioration in rural areas Treatment of waste disposal Countermeasures against air pollution Building monitoring system Establishing laws and regulations in the environmental sector 	<ul style="list-style-type: none"> Italy: monitoring infectious disease in Havana City Canada: assisting rural women UNDP: supporting programs for the socially weak in the East, funded by Italy, Norway, Spain and France UNESCO: strengthening functions of local telephone offices EU: assisting housing construction in poor areas, and supporting agricultural cooperatives, etc. NGOs: helping improvement of agricultural production, etc. 	<p>Improve social policy 3)</p> <ul style="list-style-type: none"> Assistance for policy review for improving social safety net system, focusing on health and medical care, and education <p>Strengthen infrastructure for habitat environment 1)</p> <ul style="list-style-type: none"> Policy and/or technical advice on improving living environment such as public water supply and local electrification <p>Environmental protection and other measures 1)</p> <ul style="list-style-type: none"> Technical assistance for countermeasures against water pollution of the sea and rivers in urban areas, in particular for Havana Bay purification Technical assistance for countermeasures against soil deterioration 	<ul style="list-style-type: none"> Target rural areas in particular
South-South and Tripartite Cooperation			<ul style="list-style-type: none"> UNESCO: dispatching Cuban medical and sports experts to Honduras 	<p>Promote South-South and Tripartite Cooperation 4)</p> <ul style="list-style-type: none"> Dispatch of Cuban medical staff, etc., as third country experts Coordinated cooperation in the medical sector, etc. 	<ul style="list-style-type: none"> Select fields where Japanese resources are limited