Latin America Initiative at BROOKINGS

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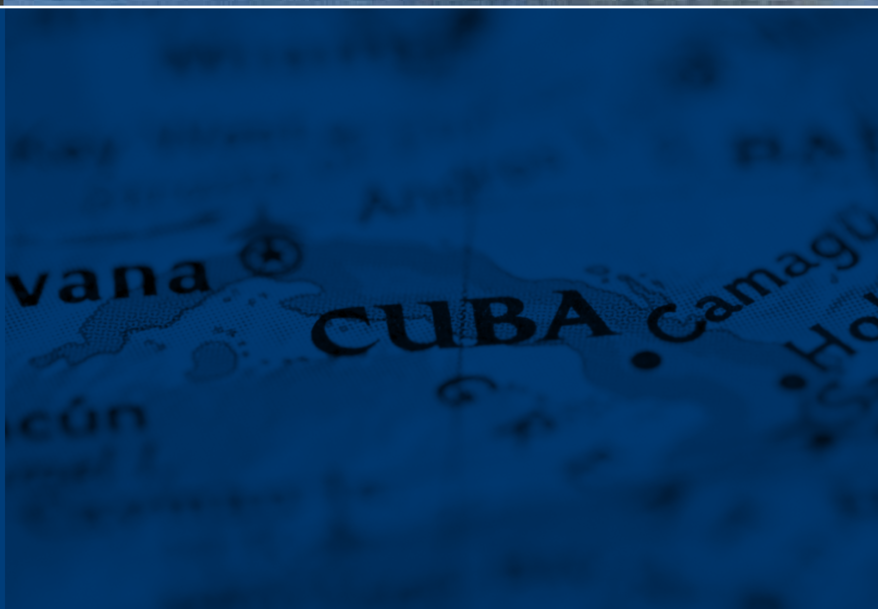
Tourism in Cuba

Riding the Wave Toward Sustainable Prosperity

Richard E. Feinberg and Richard S. Newfarmer



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Acknowledgements

Investigating the Cuban economy is like no other: official statistics are thin and often ill-defined, and access to decision-makers, whether in government ministries or state-owned enterprises, is tightly circumscribed. Fortunately, many experts in the Cuban economy and specifically in the tourism industry generously came to our assistance. We are especially indebted to those industry experts and business people in the United States and Europe and working in the island's leading hotels, in Havana and in beach resorts, that shared their extensive knowledge with us, even as they prefer to remain anonymous. During our travels, we enjoyed the warm hospitality of owners of private bed and breakfasts and enjoyed the delicious cuisine of leading *paladares*; we also spoke with innumerable employees of state-owned hotels and other tourism-related businesses, who shared their life experiences and vital insights with us.

Among the knowledgeable Cuban economists, we want to once again express our appreciation to Ricardo Torres and Juan Triana Cordoví, and most especially to the leading expert on the Cuban tourism industry, José Luis Perelló Cabrera, whose continual guidance and insights have markedly enriched this report. Thanks also to those who read and offered enormously useful comments on all or portions of draft manuscripts, including Peter Hakim, William LeoGrande, Carmelo Mesa-Lago, and several anonymous peer reviewers. Collin Laverty, president of Cuba Educational Travel, and Marla Recio Carbajal, shared their wide knowledge of all things Cuban. Sol Cuadra, Anisorc Brito, and Shihao Han provided quality research assistance.

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Acronyms

ACE	Economic cooperation associations
ADR	Average daily room rates
B&B	Bed and breakfast
CITMA	Ministry of Science, Technology, and the Environment
CAF	Andean Development Corporation
CNAP	Center for National Parks
CUC	Cuban convertible peso
CUP	Cuban peso
ETECSA	Cuban Telecommunications Company
FAR	Revolutionary Armed Forces
GAESA	Enterprise Administration Group
GOP	Gross operating profits
IFI	International financial institution
MINFAR	Ministry of the Armed Forces
MINSAP	Ministry of Public Health
MINTUR	Ministry of Tourism
MTSS	Ministry of Labor and Social Security
ONEI	Office of National Statistics and Information
OPIC	Overseas Private Investment Corporation
SMC	Cuban Medical Services
SNAP	National Parks System
SOE	State-owned enterprise
UCM	Military Construction Union
VAT	Value added tax

Section 1. Introduction

Tourism in Cuba is poised to explode. Based on Cuban government plans to construct new hotels and resorts, the number of foreign visitors could rise from 3.5 million in 2015 to over 10 million in 2030—and that does not include an additional 5 million in cruise passengers. This tourism could generate over $10 billion in foreign exchange revenues—as compared to about $3 billion today and twice the amount currently being generated by all of the island's merchandise exports. U.S. citizens are itching to join the growing number of Europeans, Canadians, and increasingly middle-class Asians and other Latin Americans to experience the island's singular allure—the flood of travelers is just over the horizon. For some, Cuba is now a trophy destination—one that visitors like to brag about to their friends.

The Cuban government's 2030 Vision Plan recognizes the centrality of tourism to the nation's future, and the government has made it a "strategic sector."[1] No other economic sector in Cuba is as ready to generate such large returns. No other sector can unlock future economic expansion and generate the foreign exchange necessary to release Cuba from the hard-currency tourniquet that has throttled growth. Eventually, agriculture and industry could take off, but not before government economic policies are thoroughly overhauled, and that will take time. Other promising sectors, such as biotechnology and the creative industries, are launching from much smaller bases. Only tourism has such a firm foundation from which to expand, and enjoys such favorable market conditions.

The importance of the government's efforts to promote the tourism industry has been underscored by the island's descent into a new austerity. Shocking the nation, in July 2016 then Minister of Economy and Planning Marino Murillo announced sharply contractionary measures necessary to cope

[1] "Diversified tourism, including marinas and boating, golf and condominiums, eco-tourism, agro-tourism, cruise ships, historical and cultural tourism, conventions, congresses and festivals, and, especially, health and wellness tourism; and emphasizing the contribution to the strengthening of the integration of the domestic economy." Communist Party of Cuba, "Plan Nacional de Desarrollo Social Hasta 2030: Propuesta de Visión de la Nación, Ejes y Sectores Estratégicos," paragraph 242, April 2016.

with rapidly dwindling foreign exchange receipts.[2] The falling international prices of nickel, refined oil products, and sugar, compounded by declining earnings from services exports—mainly medical doctors—to Venezuela and Angola, had slashed into export earnings. Further, the economic crisis in Venezuela had cut subsidized oil deliveries to Cuba by 20 percent. These events, the minister reported, would require Cuba to contract imports in 2016 by some 15 percent, and postpone 17 percent of planned investment. Electricity consumption would decline by 6 percent, by reducing the work day in state factories and public ministries and dimming public lighting. Economic growth already had slowed to 1 percent in the first half of 2016, and deepening austerity could well push the economy toward recession.

Few expect the current belt tightening to be as devastating and prolonged as during the "Special Period" in the early 1990s following the collapse of the Soviet Union and its abundant subsidies to Cuba.[3] But now, as then, the national spotlight returns to tourism as the key sector offering hope. This time, can the industry realize its long-term potential as a driver of sustainable growth, and if so, what form will it take?

This paper begins with a review of Cuban government policies toward international tourism since the 1959 revolution. We find that the Cuban leadership has had a historically ambivalent approach to the industry, turning to it only with reluctance in times of crisis. Consequently, Cuban tourism has lost market share and forfeited potentially valuable foreign exchange earnings. Today, the government is seeking to correct those policies and has ambitious plans for dramatically expanding tourism capacity.

The paper then dives down into the industrial organization of the new Cuban tourism. Drawing on conversations during our on-site visits with industry participants and experts in 2015 and 2016, we offer an in-depth analysis of the organizational structure and financial picture, including annual revenues and costs, of the large state-owned conglomerates. We also assess the partnerships of the tourism SOEs with international hotel and resort chains, through joint ventures and management contracts. At the same time, a home-grown private tourism cluster, (consisting of bed and breakfasts (B&Bs), restaurants, and associated enterprises), despite onerous restrictions, is assuming a new dynamism and offering a unique experience and flavor for visitors to the island.

We estimate that Cuba will need about $33 billion in new capital spending over the next decade and a half to achieve the government's objective of tripling the number of international-quality rooms by 2030, a daunting task in normal times and especially challenging in light of the new austerity. Financing that investment is a major challenge and policy choice that will drive the nation's entire development model.

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[2] "Cuban Minister details dire austerity measures," *Reuters*, July 9, 2016.

[3] See Philip Brenner et al., eds., *A Contemporary Cuba Reader: The Revolution Under Raul Castro*, (Lanham: Rowman and Littlefield, 2014), especially the editors' introduction.

The final section lays out policy options for Cuba to achieve its economic goals for the tourism industry and more broadly for the country. These include, among others, selectively removing obstacles to greater private and foreign investment in the sector, allowing the Cubans to sell agricultural products, labor, and services at market prices to the hotel industry, and enacting taxes that will ensure the industry contributes to national development. We also suggest policy options for the United States to support these developments, including relaxing financial and other restrictions impeding U.S. travel and account settlement, offering technical assistance on environmental issues if requested by the Cuban government, and ultimately lifting the economic embargo.

Two sets of questions run through this analysis. The first asks: who benefits from the industry's current organization? What is—and what could be—the distribution of benefits among the various industry stakeholders: the state-owned tourism groups, Cuban hospitality employees, and the public-sector treasury, and by implication, the economy as a whole? What choices could best spread benefits widely, across social sectors and geographic regions, while protecting Cuba's rich ecosystem for future generations?

Second, we ask: what are the main impediments to realizing the potential of the tourism industry? As the Cuban authorities recognized in the 2011 reform proposals for the economy as a whole and more recently in the draft Vision 2030 Plan, so too are economy-wide reforms essential for increasing the efficiency and productivity of tourism and unleashing its potential to be a driver of improved living standards in the Cuban economy.[4] While a full-blown discussion of reform scenarios is beyond the scope of this paper, we use the lens of this case study to focus on specific reforms that could help the country achieve its larger economic objectives. Since the United States—potentially Cuba's largest commercial partner—is uniquely positioned to help raise Cuban living standards, we also highlight changes to U.S. policy that, in the U.S. national interest, would support reform and growth in Cuba.

[4] Sixth Congress of the Cuban Communist Party, "Resolution on the Guidelines of the Economic and Social Policy of the Party and the Revolution," April 18, 2011, http://www.cuba.cu/gobierno/documentos/2011/ing/l160711i.html.

Box 1. Data Dilemmas, Currency Confusions, and Exchange Rate Esoterica

Data

Research and policy-making in Cuba is plagued by the absence of conventional international accounting and the absence of consistent reporting. National accounts, balance of payments, fiscal and monetary accounts are not available in forms typically found in other countries that have adopted standard accounts of the International Monetary Fund and World Bank. Similarly, firm balance sheets and income statements are not available in conventional form, if at all. Since Cuba has begun to take moves to join the Andean Corporation of Development (CAF) and its conventions require members to adopt selected data standards, it seems likely that government accounts are on the way to improvement. Its 2015 agreement to repay Paris Club creditors and share more financial data with them is another step in the right direction.

Currency

An additional complication is the presence of dual currencies with multiple exchange rates. Like most countries in the formally social bloc, Cuba had one currency for foreigners and another for domestic citizens. The purpose was to impede unauthorized interchange between foreigners and domestic nationals. These had different exchange rates against foreign currencies (say the U.S. dollar) and this allowed the government to capture foreign exchange as an effective tax. Most transition countries abandoned this practice in the 1990s. China, for example, abandoned the FEC ("foreign exchange certificate') currency for foreigners and then unified the exchange rate in 1994.

Cuba still has two currencies, each with a different exchange rate. The "convertible peso, (CUC) is pegged at 1 CUC per US dollar; the Cuban peso (CUP) is pegged at 24:1. While the latter is used by the Cuban populace, the CUC is used for enterprises and increasingly the population itself. The gap between the two exchange rates is enormous, and introduces severe distortions in the allocation of resources. To complicate matters, reforms have introduced mid-way internal accounting reforms at, for example, 10:1 to better set internal prices in national planning. While the government has long stated the objective to unify the two currencies, it has been slow to act, apparently uncertain as to the correct target rate and fearful that the sharp adjustments could be politically destabilizing. No doubt selective importing entities also oppose unification because their subsidized access to foreign exchange would disappear. In recent years, Cubans have been allowed to use CUCs, and its use has proliferated.

For purposes of this report, we have referred to CUCs at the official rate, and, where appropriate, distinguished the use of the two currencies and called attention to the cross-subsidies implied.

Source: See, among others, Pavel Vidal Alejandro and Omar Everleny Perez Villanueva "Monetary Reform in Cuba Leading up to 2016: Between Gradualism and the 'Big Bang,'" and Augusto de la Torre and Alain Ize "Exchange Rate Unification: The Cuban Case," both in Cuba's Economic Change in Comparative Perspective, eds. Richard E. Feinberg and Ted Piccone (Washington, DC: Brookings Institution, 2014).

Section 2. From Revolution to Rebirth and Expansion

The Historical Legacy of Ambivalence

The Cuban revolution nationalized U.S.-owned hotels as part of its general sweep of nationalizations that sought to eliminate the dominant U.S. economic and political influence on the island. The biggest burst of take-overs of U.S. properties, among them hotels, occurred in July 1960 in retaliation for the refusal of U.S.-owned refineries to refine crude oil from the Soviet Union.[5] Cuban privately-owned tourism establishments were swept up in subsequent waves of nationalizations.

American tourists had come to Cuba during prohibition (1920 – 1933) to freely consume alcoholic beverages; of the 80,000 tourists visiting the island in 1930, some 85 percent were American.[6] After the hiatus of World War II, tourism resumed, peaking at 272,000 in 1957; many came to try their chance at the casinos, as U.S. law enforcement in all but a few states fought to suppress gambling at home. U.S. government efforts to repress activities that many American citizens wanted and were willing to pay for created a vacuum that criminal syndicates—"mafia families"—were only too ready to exploit. In offshore Cuba, large hotel-based casinos and nightclubs were owned or operated by well-known criminals, including Lucky Luciano, Santo Trafficante, and Myer Lansky, in some cases necessarily in partnership with the Cuban strongman and president, Fulgencio Batista.[7] To many excluded Cubans, and to a revolution with deep roots in both Jesuit morality and Communist austerity, these luxury hotel-casinos symbolized all that was decadent and wrong under Batista's bloody rule.

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[5] Richard E. Feinberg, *Reconciling U.S. Property Claims in Cuba: Transforming Trauma into Opportunity* (Washington, D.C.: Brookings Institution, 2015), 11-13. On U.S. properties, see Guillermo Jiménez, *Las Empresas de Cuba 1958* (Havana: Editorial de Ciencias Sociales, 2004); and Louis A. Pérez, *Cuba: Between Reform and Revolution*, 4th edition (Oxford: Oxford University Press, 2011). A treasure trove of information on U.S. economic interests in pre-revolutionary Cuba are the files for its Cuba programs of the Foreign Claims Settlement Commission of the United States (FCSC), available at http:www.justice.gov/fcsc/final-opinions-and-orders-5#Cuba.

[6] Data generously provided by José Luis Perelló Cabrera.

[7] For a colorful account of "the era of the Havana mob," see T. J. English, *Havana Nocturne: How the Mob Owned Cuba and Then Lost It to the Revolution* (New York; HarperCollins, 2008). Yet, according to English, "there is no evidence to support the claim that the Havana Mob presided over the prostitution business […] as with narcotics and bolita (the illegal lottery), the sex trade in Cuba was left to the Cubans […]" 216. For a recent scholarly discussion of sexual relations and tourism in Cuba, see Valerio Simoni, *Tourism and Information Encounters in Cuba* (New York: Berghahn Books, 2016).

In the early days of the revolution, the new government proclaimed its elimination of the excesses and vices of the tourism industry a major achievement, grounding an ambivalence towards the industry that lingers until today.[8]

Necessity is the Mother of Opening

The collapse of the Soviet Union shocked the Cuban economy. Annual subsidies of $3 to 4 billion vanished, oil imports dropped 70 percent from 1989 to 1993, and Cuba's GDP contracted by some 30 percent. Desperate for foreign exchange, the government turned to tourism and progressively remittances from the Cuban diaspora. During the decade of the 1990s, the Cuban government invested an estimated $3.5 billion in developing the tourism sector.[9] To provide badly needed investment capital and to ensure a steady flow of tourists, Cuba welcomed European hotel chains to partner with newly created Cuban state-owned tourism groups. Leading foreign firms such as Meliá and Iberostar were invited to sign joint venture deals and to manage Cuban-owned hotels and resorts. The emphasis was on sun-and-surf tourism: resorts that were relatively easy to construct and manage and located in enclaves distant from population centers.

The first post-revolutionary wave of tourism development was designed expressly to *minimize* the linkages between the industry and the rest of the country. To ensure that tourists would not distract from Cuba's revolutionary purity, the government went so far as to prohibit Cuban nationals from entering hotels catering to foreigners. Tourists arrivals rose from very low levels in the post-revolution period to 740,000 by 1995—triple the flow that had characterized the 1950s. By 2000, new visitors had reached 1.7 million, and tourism receipts hit $2 billion (Figure 1).

Once the acute crisis of the 1990s had passed, the government's treatment of foreign investment became once again more restrictive, and by the mid-2000s, earnings growth from the tourism industry had begun to slow. Furthermore, the Great Recession of 2008 to 2009 slammed the tourism industry worldwide with hurricane force—and Cuba was no exception. Tourist arrivals and especially spending dropped. After peaking in 2005 at over $2.6 billion, tourism receipts hovered in the $2 to 2.6 billion range, before surging to $2.8 billion in 2015 (Figure 2).

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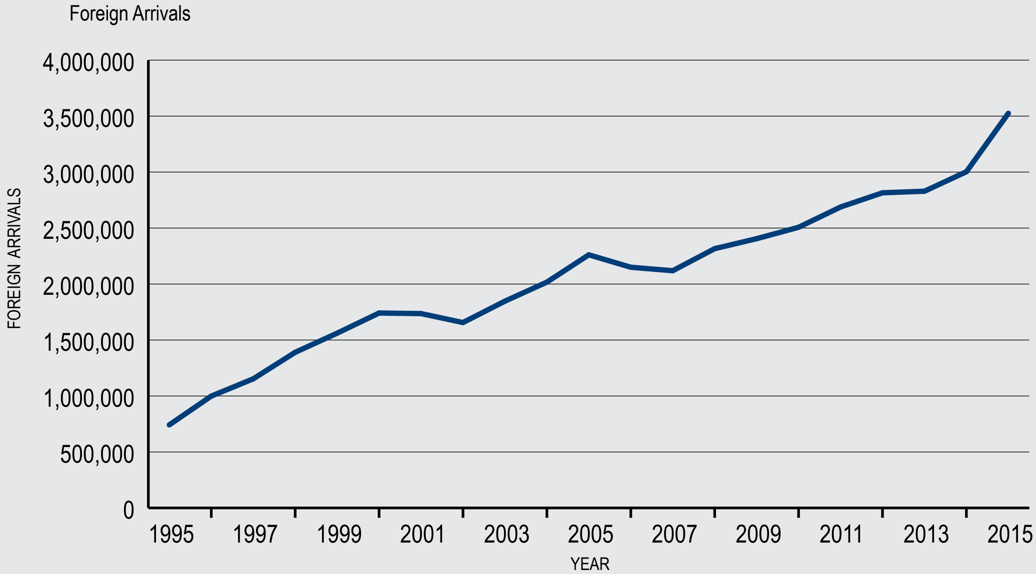
[8] No longer in office but occasionally issuing his "reflections," the aging Fidel Castro remains ambivalent. In a rebuttal to President Obama's remarks during his historic March 2016 visit to Cuba, Castro wrote in *Granma*, the Cuban Communist Party daily, that "Tourism today, in large measure, consists in showing the joys of the countryside and tasting the exquisite products of our seas, and always sharing with the large private foreign corporations, whose profits if they don't reach billions of dollars per capita are not worthy of attention." (Authors' translation)

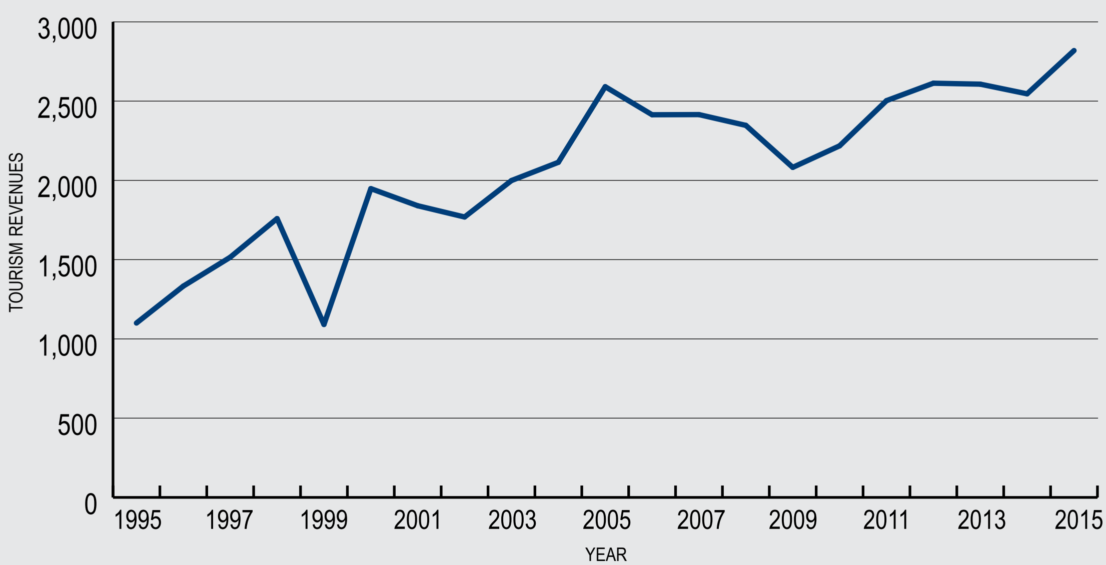
[9] Orlando Gutiérrez Castillo and Nélida Gancedo Gaspar, "Tourism Development for the Cuban Economy," *ReVista: Harvard Review of Latin America*, (Winter 2002), http://revista.drclas.harvard.edu/book/tourism-development-cuban-economy-english-version.

Figure 1. Waves of Arrivals



Source: World Bank, World Development Indicators for 1995-2014; for 2015, ONEI, *Turismo Internacional Indicadores seleccionados Enero – Diciembre 2015* p. 10.

Figure 2. ...and Revenues are Rising



Source: For 1995-2013, World Bank, World Development Indicators; for 2014-2015, Government of Cuba, Office of National Statistics and Information (ONEI), *Panorama Económico y Social 2015*, p. 36

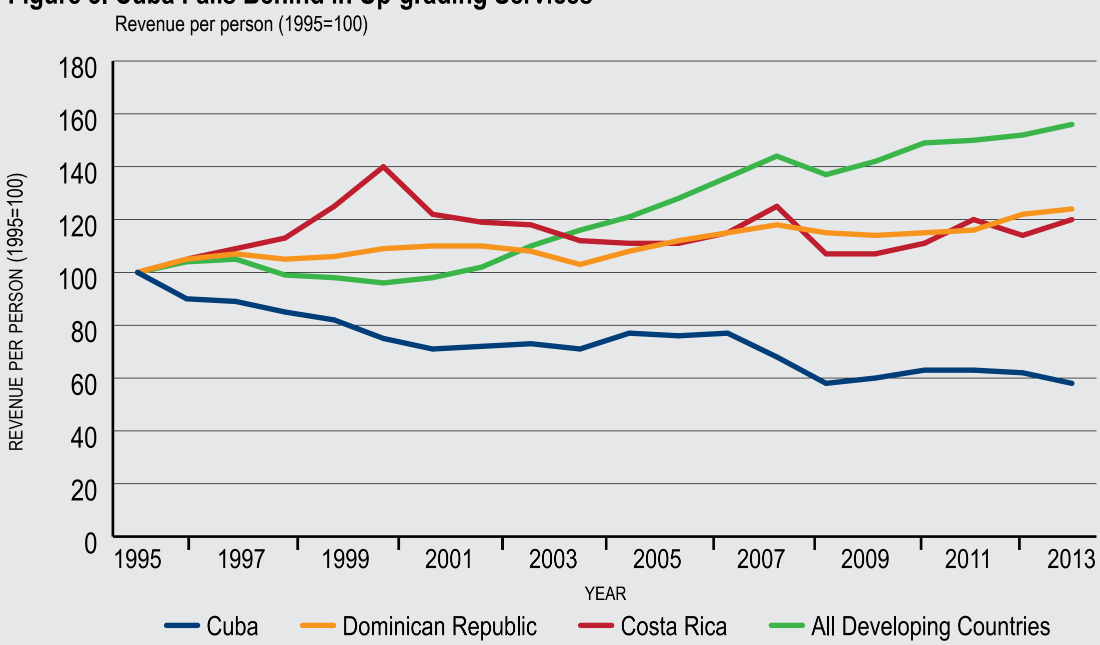
Sector Performance and Vulnerabilities

Cuba's share of tourist spending worldwide today is less than half that of the Dominican Republic, a country of similar size, endowment and location. However, the opening of new destinations around the developing world, the result of falling transport costs, and better marketing of other countries, drove down market share of all of the Caribbean countries.

The Great Recession overlay a more fundamental shift in the worldwide industry during the first decade of the new century: many new destinations around the world were opening, and with the global tourism market expanding rapidly, the Caribbean as a whole was losing market share. Thus, while from the mid-1990s to the turn of the century, Cuba and other countries in the region had gained global market share, in the early 2000s the region's market share fell. By 2014, the region's share of global receipts had fallen to well below 2000 levels, and Cuba was no exception. Indeed, Cuba's share fell more rapidly than comparable countries, such as the Dominican Republic and Costa Rica.

Beneath these statistics was a more disturbing trend. The state-owned Cuban industry was catering to the low-income end of the market. Those tourists that did visit Cuba were not of the same income rankings as the well-heeled U.S. visitors from the 1950s. These new wave tourists were spending less. The Cuban tourism industry focused on offering all-inclusive resorts to value-seeking clients from Canada (especially Quebec), Russia, and other lower-income European populations eager to grab inexpensive package deals marketed by international tour operators. Though labeled four- and five-star resorts, by international standards, the quality of Cuba's beach accommodations and service did not warrant such exalted ratings, by international standards. As a result, while travelers to the Dominican Republic and Costa Rica—and to many other developing countries—were spending more per visit, revenue per visitor in Cuba declined (Figure 3).

Figure 3. Cuba Falls Behind in Up-grading Services



Source: World Bank, World Development Indicators, various years.

Two Big External Shocks in 2015 and 2016

Today, however, tourism is booming in Cuba—the result of two big international shocks to the Cuban economy. One shock was negative: the slow but progressive tightening of Cuba's foreign exchange budget, at last becoming acute in 2016. Cuba's main international commercial partners—Venezuela, Brazil, and China—had lost their appetites for subsidizing the anemic Cuban economy, albeit for various reasons, forcing the Cuban authorities to rethink their attitudes toward the tourism industry. By late 2015, Venezuela descended irretrievably into full blown political and economic crisis, with severe implications for oil deliveries and payments for medical service professionals that Cuba exported. In July 2016, the government was forced to announce a program of severe belt-tightening to adjust to limited external resources. Cuba was once again desperate to loosen the foreign exchange tourniquet that periodically was forcing authorities to restrict imports and repress growth. Only tourism (and remittances) offered the promise of a quick injection of foreign exchange earnings.

The second shock was positive: Following the U.S.-Cuba rapprochement in December 2014, the Obama administration significantly relaxed restrictions on U.S. travel to the island, resulting in a burgeoning flood of U.S. visitors. (Travel by U.S. citizens to Cuba for tourism per se is still prohibited by U.S. law.) The number of U.S. visitors (exclusive of Cuban-Americans) rose rapidly, from 91,000 in 2014 to 161,000 in 2015 (Table 1) and is projected to reach 300,000 in 2016. In addition, Cuban-American visitors—under relaxed U.S. travel rules—reached nearly 300,000 in 2015.

Table 1. Canadians Important, but U.S. Citizens Surge

Arrivals to Cuba by source country	2015 (thousands)	2015 (percent)
Canada	1,300	36.9
United States	161	4.6
Cubans (Diaspora)	293	8.3
Germany	175	5.0
UK	156	4.4
France	138	3.9
Italy	138	3.9
Spain	107	3.0
Mexico	105	3.0
Venezuela	95	2.7
Argentina	85	2.4
Cubans (Non-U.S.)	98	2.8
China	32	0.9
Other	642	18.2
Total	3,525	100.0

Source: ONEI, "Turismo Internacional: Indicadores seleccionadas," March 2016; and José Luis Perelló Cabrera, "Tourism development in Cuba," (Presentation to the Association for the Study of the Cuban Economy, July 2016).

Cuban Tourism Capacity: Limits to Growth?

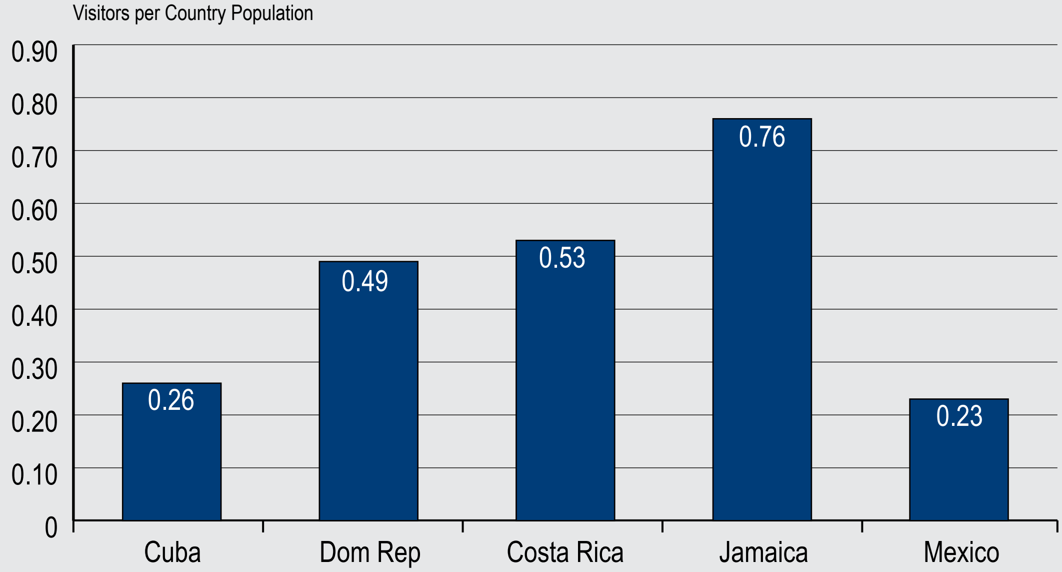
Even a cursory review of Cuba's many sights and attractions illuminates why the country can harness tourism to drive growth. The neighborhood of Old Havana (*Havana Vieja*) abounds with marvelous colonial squares surrounded by architectural gems just waiting for the continuing renovations that will accommodate the anticipated waves of well-heeled tourists. The UNESCO supported World Heritage Site of Colonial Havana—one of nine World Heritage Sites on the island (the most in any country of Latin America)—begins to convey this history. Endless stretches of beaches, protected by natural bays and strings of sand bars and islands, are already attracting millions of tourists each year. Less developed but also holding great tourism potential are the welcoming provincial towns and, for the more adventurous travelers, the vast systems of protected parks, ecological reserves, and coral reefs.

These varied attractions raise the specter of a wave of visitors coming to the colonial old town and quickly spoiling the very tourist assets that attract them. Indeed, if not well managed, Old Havana may come to resemble favorite tourism destinations such as Venice and Quebec City or the city centers of such tourism meccas as New York, Buenos Aires, London, and Paris. In 2015, Havana hosted 1.7 million visitors, and the Ministry of Tourism (MINTUR) projects a 37 percent jump in 2016.[10] But Cuba as a whole runs little risk of becoming overrun by foreigners. On the contrary, there is plenty of scope for the expansion of tourism on the island. One common indicator of a nation's tourism potential is the ratio of international tourist arrivals to population. By way of comparison, this ratio in the Dominican Republic is 0.49, in Costa Rica 0.53, and in Jamaica 0.76, whereas in Cuba the ratio of tourists to the population had only reached 0.26 in 2014 (Figure 4).

To some tastes, the Varadero peninsula is already over-crowded, yet its hotel density is low compared to the competition in Mexico (Cancún) or in many other summertime beach resorts worldwide (think the Spanish Costa Brava, Chile's Viña del Mar, or New York's Coney Island), all falling well short of the density in Brazil's Copacabana. Even after completion of the Cuban government's ambitious hotel expansion programs, only a small fraction of the 1,400-plus islands and bays along the island's 5,746 kilometers of coastline will have been touched. Nevertheless, even this limited growth will have to be carefully managed if the new influx is to avoid bringing with it environmental damage.

[10] Minister of Tourism Manuel Marrero, (presentation to FITCuba, Havana, Cuba May 4, 2016).

Figure 4. Cuba Still has a Low Volume of Tourists Relative to Other Countries



Source: World Bank, "International tourism, number of arrivals," http://data.worldbank.org/indicator/ST.INT.ARVL.

Section 3. The Industry Structure Today

The tourism industry is ostensibly regulated by the Ministry of Tourism. Yet other ministries also have important voices in the industry—the Ministry of Labor and Social Security (MTSS) through its approval of worker permits in the sector and effective tracking of employment in private bed and breakfasts (*casas particulares*); the Ministry of Public Health (MINSAP) for medical tourism; and the Cuban Ministry of Science, Technology, and the Environment (CITMA) for eco-tourism. Most notably, the Ministry of the Armed Forces (MINFAR), through its holding company, the Enterprise Administration Group (GAESA), manages a sizeable share of the industry, as its tourism operations include Gaviota S.A. and the large Gaviota Hotel Group. Hotel operations, as discussed below, constitute the bulk of state sector earnings. In addition, the state sector deploys its own construction firms, sometimes in partnership with the French construction giant, Bouygues; the real estate holding companies (*inmobiliarias*) are the official owners of the hotel buildings, and are responsible for maintenance. The Cuban state, through the Institute for Physical Planning (*Instituto de Planificación Fisica*), grants these *inmobiliarias* long-term usufruct rights, maintaining the legal formality that it is only the state—as the embodiment of the Cuban people—that owns land in Cuba.

As in other economic activities, the state is the dominant actor in the sector as owner of main services, regulator of resource flows, and recipient of investible funds and general revenue. However, in recent years, the non-state sector has grown through the proliferation of restaurants (*paladares*), private room rental (*casas particulares*), and self-employment (*trabajadores cuentapropistas*, TCPs) serving the industry, such as private construction companies and taxi drivers.[11]

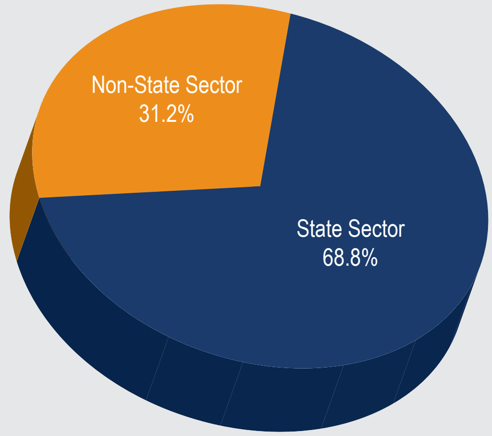
Indicators, however imperfect, signal the growing importance of the non-state sector. In 2015, state companies and agencies reported tourism revenues of CUC 2.3 billion of total revenues of CUC 3.3 billion in 2015—about 69 percent of total tourism spending (Figure 5). State entities reported

[11] For a quantitative analysis of the emergence of these private activities, see Richard E. Feinberg, *Soft Landing in Cuba? Emerging Entrepreneurs and Middle Classes* (Washington, D.C.: Brookings Institution, 2013).

revenues of CUC 1,940 million from foreign tourists and CUC 310 million from Cuban nationals.[12] The proportion of state revenues to total spending was nearly identical in 2014 as well. Similarly, of the 71,000 estimated rooms available to accommodate international tourists, about 16,000—or nearly one quarter—are private offerings (see Annex A). These numbers, taken by themselves, understate the importance of the state because of its role as owner, regulator, and investor, but it is incontrovertible that private enterprise is also playing a substantial and dynamic role in the tourism industry. Consider first the state sector.

Figure 5. The State is Still Preeminent, but the Non-State Sector is Now Substantial

Tourist Spending: Shares of State and Non-state Revenues



Source: Authors' calculations as described in footnote 13 based on ONEI, "Turismo Internacional. Indicadores Seleccionados Enero-Diciembre de 2015 March 2016; and ONEI, Turismo Nacional. Indicadores Seleccionados Enero-Diciembre de 2015 July 2016; and ONEI Panorama Economico y Social Cuba 2015.

The State-owned Sector: A guide to complex industrial organization

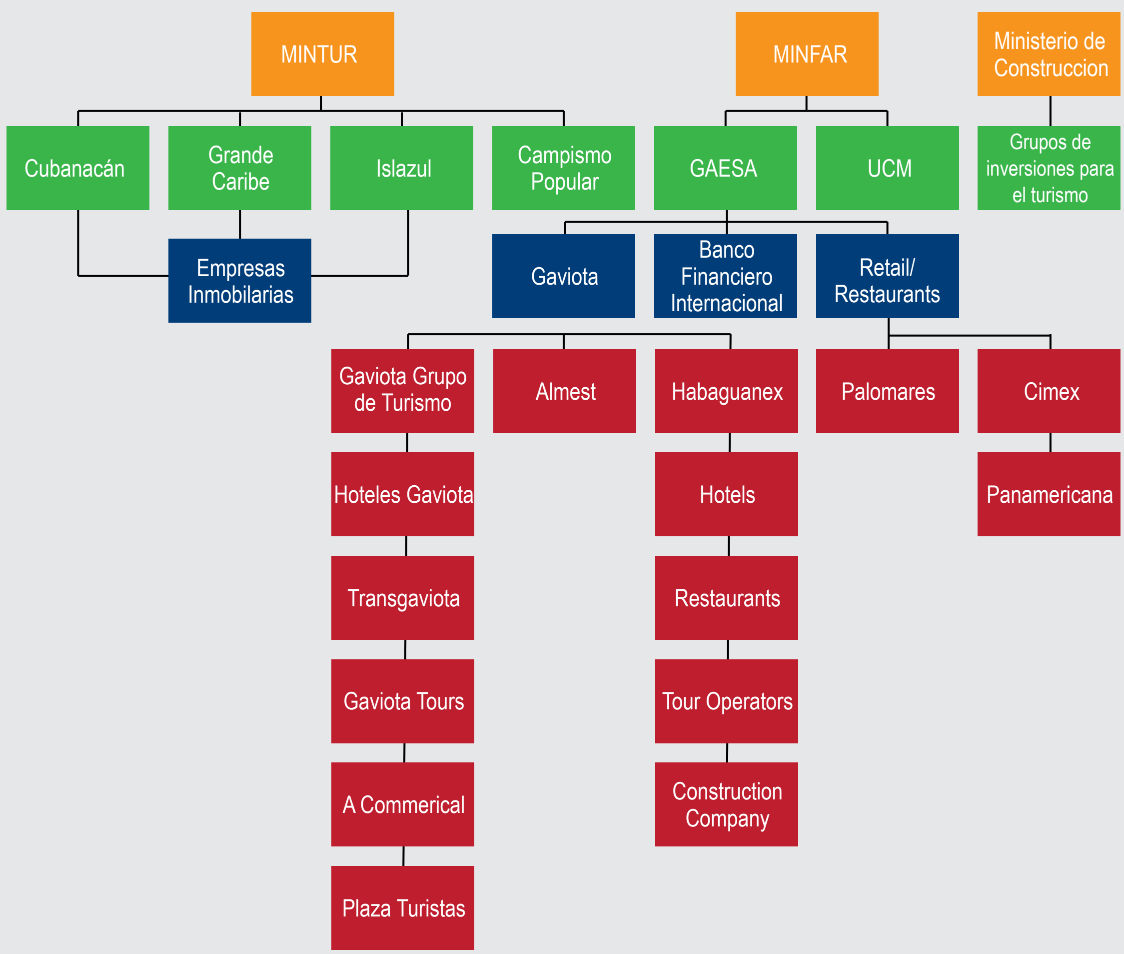
In the international tourism accommodations sector, hotels and resorts are grouped within just a few state-owned enterprises (SOEs) (Figure 6). Two of these large SOEs operate under the aegis of MINTUR—Cubanacán, and Grand Caribe. MINTUR also oversees Islazul and Campismo Popular, both primarily serving domestic tourism. Until its recent absorption by GAESA/Gaviota, Habaguanex operated boutique hotels, restaurants and other retail outlets in Old Havana under the direction of the Office of the Historian of the City of Havana.[13] Even before this acquisition, the largest and most rapidly growing SOE hotel operator was the Gaviota Tourism Group, itself controlled by GAESA and, ultimately, the Cuban military. The GAESA holding company also comprises the Banco Financiero Internacional, which often works in tandem with the construction companies and hotels to finance hotel construction.

[12] Total spending in 2015 includes CUC 2,819 from international tourists and an estimated CUC 450 million Cuban national tourists. Total foreign tourist spending for 2014 comes from ONEI, *Anuario Estatistica de Cuba 2014 Turismo Edición 2015*, table 15.11 "Ingresos asociados al turismo internacional" (CUC 2,546 million); for 2015, ONEI, *Panorama Económico y Social 2015, Edición Abril 2016*, Table 28, "Ingresos asociados al turismo (MMCUC)" (CUC 2,819 million), 36. Foreign spending in state entities in 2014 and 2015 is reported in ONEI, Turismo Internacional Indicadores Seleccionados enero-diciembre 2015 (Edición Marzo, 2016), Table 9, "Ingresos de las entidades turisticas" (CUC 1,752 and CUC 1,940 million, respectively), 9; spending of Cuban nationals for domestic tourism for 2014 and 2015 comes from ONEI, *Turismo Nacional, Indicadores seleccionados enero-diciembre 2015*, Table 1 "Ingresos (Entidades Turisticas) - MMCUC" (CUC 277 million and CUC 310 million, respectively). To estimate total private spending of Cuban tourists, we assume conservatively that domestic tourists will spend at least the same amount in private hotels and restaurants and so multiply 310 times 1.45; this is likely to produce a marginally underestimated non-state share in figure 5.

[13] "Habaguanex Hotels," http://www.habaguanexhotels.com/; Andrea Rodriguez, "Cuban military expands its economic empire under détente," Associated Press, September 7, 2016, http://bigstory.ap.org/article/1a473ab397bb4868a4c1c4fae7f4a816/cuban-military-expands-its-economic-empire-under-detente.

Each of the SOEs is a tourism "group" or conglomerate, which, in addition to hotels, manages various tourism-related businesses. For example, Gaviota operates the bus line Transgaviota (with some 3,300 vehicles), Gaviota Viajes tourism agency (includes Via car rentals), Marinas Gaviota (including the 1,200-slot Marina Varadero), Crucero del Sol (catamaran excursions), AT Comercial (supplies), Plazas Turisticas (small shopping malls), and Tiendas Gaviota (tourism promotion, retail outlets).[14] The major tourism groups also include a construction firm and a real estate developer (*inmobiliaria*) which holds ownership of the properties and leases them to the SOE operator. In the case of Gaviota, these are, respectively, the Union de Construccion Militar (UCM) and Almest. Each major group also has its own human resources entity (*entidad empleadora*). Cubanacán operates the health clinic that serves tourists, the Clinica Central Cira Garcia.

Figure 6. A Few State Conglomerates Dominate the Cuban Tourism Sector



Source: Websites of each SOE, author interviews with industry experts.

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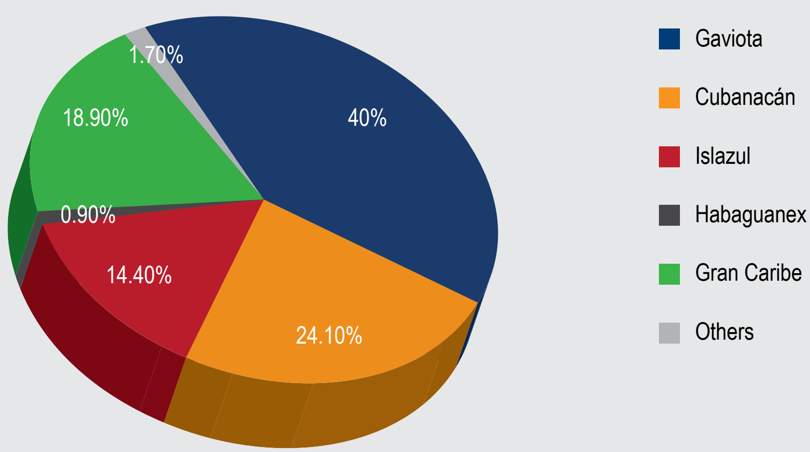
[14] "Gaviota S.A.," http://www.gaviota-grupo.com/en; Katheryn Felipe González, "A look inside Cuba's largest tourism enterprise," *Granma*, September 7, 2016.

Gaviota is responsible for about 40 percent of total room capacity, Cubanacán operates 24 percent, and Gran Caribe 19 percent (Figure 7). MINTUR and MINFAR report to the Council of Ministers, Cuba's governing cabinet. Gaviota's dominance is even more marked when taking into account only the four-and five-star hotels, where international tourists are most likely to stay (Table 2). Gaviota's four- and five-star rated hotels offer over 18,000 rooms, whereas Cubanacán offers just half that amount, and Gran Caribe, with a much higher percentage of inferior accommodations, accounts for under 4,000 highly-rated rooms (including two iconic venues, the Havana Libre and the Hotel Nacional, both in need of major renovations). Of the nation's 18,363 five-star rooms, Gaviota provides a market-dominating 13,815, with their higher per-room rates (Annex B lists the names of hotels with their room count, by SOE.)

Figure 7. Gaviota is the Main Player in the Sector

Market shares of state-owned tourism groups, 2015



Source: José Luis Perelló Cabrera, "Cierre 2015 Por Entidades de Alojamiento," private communication, 2016. The total number of rooms in the state sector was 64,231.

Table 2. Market Shares of SOEs, Number of Rooms (International Hotels Only)

	Gaviota	Cubanacán	Gran Caribe	Habaguanex
Five-Star	13,815	3,400	998	150
Four-Star	4,512	5,957	2,873	298
Total	18,327	9,357	3,871	448

Source: Web sites of each SOE, SOE printed brochures, cubahotelreservation.com. For more, see Annex A.

With a 40 percent share of the tourism hotel rooms, Gaviota is nearly as large as the combined market share of the two main MINTUR holdings, Cubanacán and Gran Caribe, and Gaviota is growing more rapidly. As with other SOEs, Gaviota does not release audited annual reports, and it is difficult to distinguish certain holdings and income streams from the parent entity GAESA and between GAESA and the ultimate holding company, the Revolutionary Armed Forces (FAR). The corporate headquarters of GAESA and Gaviota are housed in the same building, the historic La Marina in downtown Havana. It seems likely, however, that the cash flows from all its tourism-related activities, from construction to restaurants, are substantial. Gaviota affirms revenues of over $700 million a year from its hotel operations alone, although without offering substantiating details.[15]

Urban Culture Versus Beach Tourism

A key divide is between Havana urban or cultural tourism versus beach tourism, primarily within the large all-inclusive resorts. Of about 44,000 available rooms classified as four- and five-star where international tourists are most likely to stay (Table 2), about 5,900 were located in Havana, the vast majority of the remainder were located in "tourism poles" at Varadero and other beach resort areas.[16] Of total available rooms, Havana accounted for only 18 percent, reflecting Cuba's decision to invest in its beaches and to attract tourists seeking sun and surf (*sol y playa*). If MINTUR projections are realized, the high ratio of beach/Havana tourism will remain rather steady in coming years. It is less complicated to build additional big-box hotels on vacant beaches than it is to locate and permit new urban structures. Moreover, because occupancy rates and profit margins are higher in Havana—and leapt another 30 percent in November 2016 in response to the surge in U.S. and European visitors—the major state-owned enterprises, notably the Gaviota Tourism Group, are reserving those prime locations for themselves.

The government has realized the advantages of expanding cultural tourism beyond Havana. In the last two years, it has provided resources to invest in other urban centers, including Cienfuegos, Trinidad, Santa Clara, Camaguey, Holguín, and Santiago. Even so, these areas lag sharply behind Havana, having arguably received proportionally less investment than their tourist potential might otherwise indicate.

U.S. trade restrictions on tourism have given a powerful boost to cultural, urban tourism. To sell packages to Americans, tour operators have to embrace educational, people-to-people learning experiences. Packages in 2014 to 2016 steered the incipient tide of Americans away from beaches and toward urban and inland destinations, ranging from Havana's colonial old town to tobacco plantations, rum factories, and other places of historical interest.

[15] "Negocios," Gaviota S.A., http://www.gaviota-grupo.com/es/negocios.

[16] With regard to rooms in Havana, the authorities made these numbers available as of May 2016: 11,306 total rooms of which 52 percent were four- and five-star, 19 percent were three-star and the remaining 28 percent were one- and two-star. Frank País Oltuski, Marketing Vice President, Gaviota Tourism Group, (slide presentation to FITCuba 2016, Havana, Cuba, May 5, 2016). These numbers are for 2015 (see Annex B), applying the same ratio as given for 2014 in ONEI, *Anuario Estadistica de Cuba* 2014, "Tourism," Table 15.8.

Foreign Collaboration

The tourism SOEs engage in three types of collaboration with foreign firms: 1) joint ventures (JVs), where the Cuban SOE typically retains a majority 51 percent share; 2) management and service contracts, where the SOE looks to its foreign partner to help manage the establishment and through its tour operators to fill hotel rooms, in return for a fixed annual fee often supplemented with an incentive performance premium based on a percent of operating profits; and 3) a management contract linked to an infusion of credit, typically of medium-term (three- to five- year) duration bearing interest rates of about 8 percent, especially common when construction or significant renovation is required.

Fully two-thirds of hotel rooms operate under one of these three modes of international collaboration.[17] Notably, 84 percent of hotels in the four- and five-star category are either JVs or under foreign management contract—lumped together in Cuban terminology as international economic associations, (*asociaciones de cooperacion economica*, ACE). According to a leading Cuban academic authority on tourism, Jose Luis Perelló, 17 foreign firms are engaged in such ACEs, operating 39,422 rooms in 86 establishments (Table 3); the top three foreign firms—Meliá, Blue Diamond, and Iberostar—account for two-thirds of the rooms. According to MINTUR, 27 joint ventures account for 5,906 rooms, confirming that the lion's share of establishments under foreign collaboration are not JVs but rather management contracts.[18]

Table 3. Foreign Participation is Mainly Through Management Contracts

	Foreign Management	Rooms	Hotels
1	Meliá Hotels International	13,480	30
2	Blue Diamond	8,472	14
3	Iberostar	4,651	12
4	H10	2,040	4
5	BLAU	1,777	3
6	Warwicks Hotels	1,243	2
7	ACCOR	1,081	3
8	Valentín	1,020	1
9	Sercotel	984	2
10	BlueBay	976	3
11	Barceló	883	2
12	Be Live	781	2

Source: Web sites of each SOE, SOE printed brochures, cubahotelreservation.com websites, and printed brochures of the various hotel chains. For more, see Annex A.

[17] Data in this paragraph are from Minister of Tourism Manuel Marrero, FITCuba presentation, and Gaviota slide presentation, slides attributed to MINTUR, FITCuba, Havana, Cuba May 5, 2016.

[18] Sheyla Delgado G di Silvestrelli and Katheryn Felipe, "El turismo Cubano: entre lo estratégico y lo sostenible," *Granma*, May 4, 2016, http://www.granma.cu/Feria-Internacional-de-Turismo-2016/2016-05-04/el-turismo-cubano-de-lo-estrategico-a-lo-sostenible-04-05-2016-11-05-22.

Looking forward, MINTUR projects that of the 107,900 new rooms to be added between 2016 and 2030, more than 30,000 will be with foreign investment.[19] If so, that would indicate a government preference to significantly increase the percentage of rooms with foreign capital participation. Still, some 70 percent of new capacity would be financed with domestic capital (in some cases temporarily supplemented with medium-term international loans).

Incentives and Decision-Making in the State Sector

The opacity of decision-making in Cuba generally, coupled with the lack of data, make assertions about decision-making, incentive structures, and motivations and constraints of key actors necessarily somewhat speculative. As with other Cuban SOEs, the tourism groups do not publish financial or annual reports, and their Cuban executives are rarely accessible to academic researchers or journalists. The precise decision-making tree between MINTUR and the SOEs is not transparent; moreover, the nexus of corporate authority is in transition, as Cuba gradually decentralizes decision-making from central government ministries to individual SOEs. Nor do the SOEs articulate their decision rules, e.g., whether they are optimizing some measure of rates of return on investment, total revenues, taxes paid to the state, wages paid to workers, or some other social function. Nonetheless, the institutional arrangements in Cuba actually seem to be relatively well aligned at the micro level to produce positive growth outcomes in the sector.

For example, in the state sector, checks and balances between the government owners of tourist assets and foreign hotel managers under contract seem well aligned to ensure reasonably good customer service and growth. Expatriate managers representing their international hotel chains report regularly—monthly and quarterly—on performance to vigilant delegations from the ownership group. SOEs press hotel management to keep costs low and to produce strong positive cash flows. Incentives built into management contracts typically contain progressively rising rewards proportionate to performance in terms of revenues. Reporting on outcomes and near-term forecasts cover a huge array of measures, ranging from occupancy rates and revenue per room to ratings on Trip Advisor. Though some European hotel chains have thrown up their hands in frustration with bureaucratic oversight and excessive controls and eventually withdrew from management contracts in Cuba, many other companies (Table 3) have learned how to operate in Cuba in an arrangement that is profitable for both the government and for the company.[20]

More speculatively, rivalry seems appropriately balanced with sector coordination to produce increased sector investment in a relatively planned way. This is not full price competition, as even in

[19] Ibid. In his FITCuba 2016 oral presentation, the CEO of Gran Caribe, Eduardo Acosta said there would "many" management contracts with foreign firms but did not mention JVs. However, he told one of the co-authors that his firm would also enter into new JVs, especially in the beaches just east of Havana (Playas del Este).

[20] Prominent among those companies abandoning the market was the Jamaica-based Sandals Resorts.

market economies, large hotel chains have some market power to set prices.[21] The primary constraint on high prices is competition with neighboring countries.

Within the sector, offerings do not appear specialized, as each SOE offers both urban and beach facilities (with the exception of Habaguanex which had been geographically restricted to Old Havana and its surroundings) spread among the four and five-star quality ratings, although Gaviota and Cubanacán account for most of the five-star destinations (Table 2). Some industry experts have proposed a cost-savings merger between the two internationally-focused MINTUR holdings, Cubanacán and Gran Caribe. Notably, Gaviota has escaped the umbrella of MINTUR, operating instead under the FAR's large holding company, GAESA. According to industry experts, whereas there is some degree of information-sharing between MINTUR and Gaviota, Gaviota guards its autonomy and does not share its detailed financials with MINTUR and not even with the government statistical office, ONEI (Oficina Nacional de Estadísticas e Información). Nonetheless, the MINTUR groups and Gaviota are generally aware of each other's activities and plans.[22]

In other areas, the industrial organization would appear to have incentives less aligned with efficient firm behavior. Maintenance is one. Because the assets are owned by the real estate companies (*inmobilarias*) rather than by the hotel leases (the state-owned tourism company), resolution of large maintenance problems is often delayed, causing rooms to remain vacant, elevators to be inoperative, or major cooling systems to be off-line. The problem is two-fold: the real estate companies have to submit their budgets to the national planning authority on an annual basis, injecting rigidities into resource allocation; typically, they are awarded amounts that are insufficient to fully cover maintenance costs. Not infrequently, maintenance budgets become exhausted well before year-end. This sometimes means that rooms cannot be used and so revenue is lost.

A second area where incentives for maximum performance are only partially aligned concerns labor. Because hotels contract with labor management companies (as required by Cuban law for joint venture arrangements), they have limited control over wage decisions, promotions, hiring, and firing. The tourism sector attracts unusually well-educated employees, as it provides partial remuneration in CUCs and access to customer gratuities, as well as relatively pleasant working conditions; nevertheless, service quality falls short by international standards. The separation of full management control from final decisions on individual rewards misses an opportunity to raise worker productivity and to promote Cuba as a high-quality tourism destination.

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[21] Larry Dwyer, Peter Forsyth, and Wayne Dwyer, *Tourism Economics and Policy* (Tonawanda: Channel View Publications, 2010), 9. Such "interdependence" may be the result of market-driven price signals or industry collusion.

[22] Gaviota appears proud of its brand and brags that it is "the most rapidly growing" of the tourism SOEs. By all accounts, it is the most liquid. It has turned down offers from international investors for capital, preferring to finance expansion through its internal cash flow. In contrast, other SOE projects are suffering construction delays due to lack of finance. For example, in Trinidad, during construction of a 50-room joint venture hotel between a foreign investor and Cubanacán, the foreigner partner, perhaps tired of delays, backed out, leaving the site unfinished. Author interview with industry executive, Trinidad, Cuba, May 2016.

Investment, considered in depth below (Section 5), is a third area where incentives embedded in the industry's organization are not fully aligned with broad national objectives.

The Private Sector: Booming under the Radar

The private bed and breakfasts operations (*casas particulares*) are undoubtedly the most rapidly growing sector of accommodations serving foreign tourism. B&Bs offer roughly one-quarter of Cuba's available accommodations; no doubt their numbers are growing rapidly, as is evident from a stroll around Havana's Vedado neighborhood, Trinidad, or other major tourist towns. Estimates put the number of B&B rooms at about 22,000, of which some 16,000 are available to international tourists and accept payment in CUCs (see Annex B).[23]

Private B&Bs are unusually efficient engines of growth. Though precise numbers are not available, B&Bs mobilize savings and channel them into a productive activity. They mobilize private domestic savings by providing higher returns than other activities: it is not unheard of to learn of families selling off automobiles to invest in a room or small apartment to rent to tourists. Families working on their houses—"sweat equity"—is another form of private savings and investment. No less important, they attract foreign remittances to finance their expansion, likely the dominant source of investment finance in this sector, as few Cubans have access to bank credit.[24] The large Cuban diaspora annually transfers an estimated $1 to 2 billion and it is a fair bet that much of this has gone into real estate investments, *paladares*, and *casas particulares*. These activities also help to refurbish otherwise dilapidated buildings. B&Bs are also much less expensive per room to build. Adding or remodeling a room for rent might cost $15,000 to $25,000, whereas each new hotel room costs some $200,000.

The sub-sector is set to grow even faster with the entrance of Airbnb, which began operations on the island in 2015. This has already accelerated foreign tourists' use of B&Bs. The number of listings has risen rapidly to over 4,000 today. The system solves the trust problem that inhibits expansion of this market. The prospective client can go online, obtain listings in a particular area, and read tourist reviews of particular houses. For their part, prospective renters can read reviews of potential guests before accepting them. Moreover, by allowing payment with credit cards in the clients' home country before departure, tourists circumvent one financial restriction, the foreign exchange tax, and have a guarantee of lodging upon arrival. Incentives facing buyers and sellers in the market are well aligned to produce a well-informed transaction.

In Cuba, individuals are allowed only two residences: a main residence and a vacation home. Increasingly, individuals are owning and renting out numerous rooms and apartments and even whole

[23] Minister of Tourism Marrero, FITCuba presentation, gave the figure of 16,000, where tourism industry expert José Luis Perelló Cabrera, referencing unpublished official data, suggested 22,000 if one includes B&Bs catering to domestic tourists.
[24] Feinberg, 2013.

homes—by placing the additional units in the names of their spouses and other family members. Over time, an industry of modest rentals of extra bedrooms is morphing into "hostels" or whole buildings which are gradually upgrading to become boutique hotels. These attractive private accommodations, with their personalized service, are adding a unique feature to urban tourism in Cuba that is usually associated with semi-rural settings, such as Coastal Maine, the Spanish Costa Brave, or Croatia on the Adriatic Sea.

In some settings, traditional hotels and private B&Bs might perceive each other as competition. In Cuba, however, the acute shortage of tourist accommodations in urban centers renders the two tourism modes complementary. In Trinidad, there are six times more B&B rooms available than formal hotel rooms—about 1,200 versus 200. One hotel regularly refers tourists it cannot accommodate to B&Bs operated by its own employees.[25] Addressing a large audience at the 2016 annual international tourism fair, FITCuba, Minister of Tourism Manuel Marrero announced that official tourism agencies are now contracting with private B&Bs, and that in Cuba "there is only one tourism, state and private together."[26] This ministerial statement signaled an important shift in government thinking regarding the roles of the public and private sector in Cuba's evolving economic development model, toward a more pragmatic, hybrid paradigm.

A cluster of private enterprises is emerging outside of the SOE-dominated official tourism sector. The government-owned hotels and restaurants are unable to accommodate the growing swells of tourist arrivals, and many do not offer the quality or type of service that some tourists demand. Already, there are over 1,700 private restaurants (*paladares*) around the island and over 500 in Havana alone. Furthermore, B&Bs are driving other private activities, including private construction companies and furniture manufacturing, as well as agricultural markets. This thriving private tourism cluster was less apparent in earlier days, even as some commentators continue to warn that increasing U.S. tourism would only benefit SOEs and the Castro government.[27]

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[25] Authors interview, hotel manager, Trinidad, May 2016.
[26] Marrero, FITCuba.
[27] For example, Editorial board, "Cubans don't benefit from American business–Castro does," *Washington Post*, September 16, 2016, https://www.washingtonpost.com/opinions/cubans-dont-benefit-from-american-business--castro-does/2016/09/16/674e32b2-79e5-11e6-bd86-b7bbd53d2b5d_story.html?tid=a_inl&utm_term=.b5a204af87c6.

Section 4. Who Benefits: Linkage v. Leakage?

Critiques of tourism frequently point to the profits of foreign operators and high import content of the industry to assert that the industry has limited benefits for the recipient economy because many of the potential revenues leak out of the host country. An examination of the benefits can look at the question through several optics. One is by looking at the direct benefits of tourism expenditures on the local economy. Another is by looking at profitability and who controls resources in the sector. A third optic is looking at specific categories of expenditures. In our conclusions and recommendations (Section 6), we propose more equitable and efficient taxation solutions.

As an overview, numbers put together by Oxford Economics for the World Travel and Tourism Council indicate that tourism in Cuba provides about 2.5 percent of GDP in direct contribution to national income and some three times that amount if indirect and induced effects are considered.[28] While these data, as with Cuban statistics (see Box 2), are subject to some imprecision, these estimated direct effects are broadly consistent with the reported international tourism revenues as a share of GDP.[29] Below we look at micro evidence that lends credence to this view of direct benefit magnitudes.

While it is incontrovertible that tourism has substantial linkage effects in Cuba, the history of the industry and organization of the economy today would imply that these are less than in other countries. The industry was born as a purposeful enclave isolated from the rest of the economy—and even Cubans were not permitted to stay in the beach hotels until the mid-2000s. Only recently has

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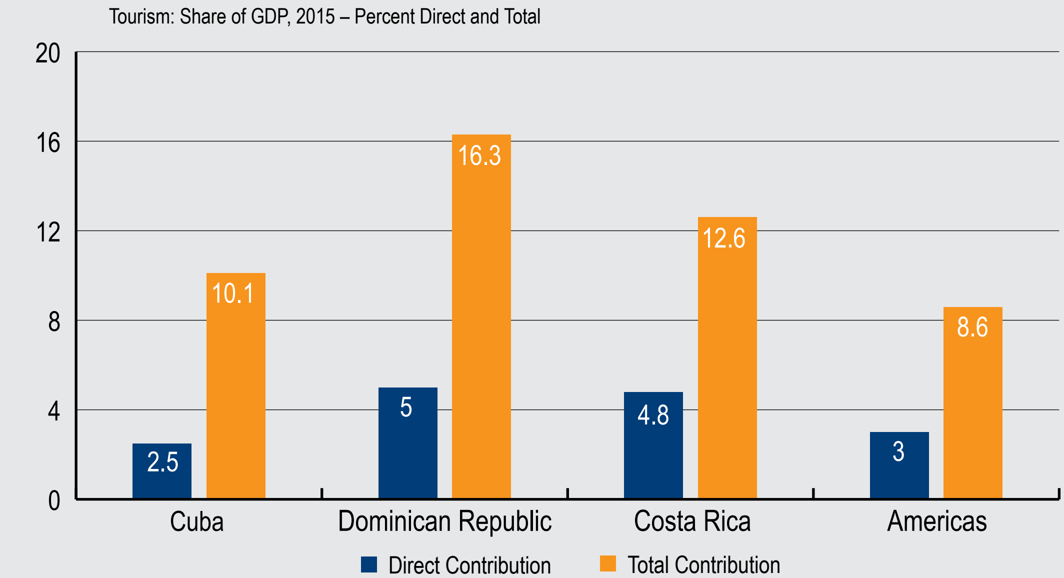
[28] "Direct tourism expenditures," as calculated by Oxford Economics for the WTTC, is calculated from total 'internal' spending after netting out imported purchases made by the different tourism sectors. Indirect effects include expenditures made throughout the supply chain, including, for example, purchases of food and cleaning services by hotels, of fuel and catering services by airlines, and IT services by travel agents as well as investment spending for construction and transport equipment and facilities. "Induced spending" includes expenditures of personnel working directly and indirectly in the tourism industry. (See Oxford Economics, *Methodology Travel & Tourism Economics Research*, March 2016 http://www.wttc.org/-/media/files/reports/economic-impact-research/2016-documents/2016methodology-final.pdf.) The estimates of direct effects undoubtedly have a higher confidence interval than total effects, especially in the case of Cuba where data are less complete than in other countries; both the indirect numbers and "induced effects" for Cuba have to be taken as rough estimations because of the absence of published input-out tables and reliable national accounts.

[29] For example, in 2015 recorded revenues from tourism in Cuba were some $3.0 billion, or about 3.7 percent of GDP.

the government sought to encourage the expansion of the industry outside the major resorts and Havana. For these reasons, the industry in Cuba, according to these aggregate estimates, has only about half the direct benefit that it does in the Dominican Republic and Costa Rica, and somewhat less than the average for the Americas. These numbers also illuminate the potential for the industry to contribute more.

Figure 8. Tourism Contributes Importantly in Cuba, but Less than in Other Countries



Source: World Travel and Tourism Council

Profits to State Enterprises: Hotel Revenues and Expenditures

Microeconomic analysis focusing on the components of revenues and expenditures of the industry reinforce the view that the industry is contributing substantially to the country's development—and highlights ways it could contribute more. In the absence of published data on Cuban SOEs, we have boldly constructed an illustrative profit and loss for a large hotel (500 rooms) providing ballpark estimates of operational revenues and costs (Table 4). Our sources included industry officials in the United States, Europe, and Cuba as well as secondary sources.[30] We posit revenues per night of $180 per room and an occupancy rate of 70 percent (higher than the 60-65 percent occupancy rates recorded in recent years but consistent with the rates being recorded today). For the global tourism industry, industry sources indicate gross operating profits (GOP) can range from 30 to 50 percent of sales. In this illustration, we arrive at a GOP of 35 percent. After deducting a management fee of 6 percent (since most five-star Cuban hotels are managed by international chains) and a 10 percent labor contribution (*aporte*), the return as measured by gross operating profits on revenues is 30 percent (before rent, taxes and interest).

[30] See, for example, Caribbean Hotel Association "Taxation and Operating Costs for the Caribbean Hotel Sector" November 2006, which breaks down operating costs for a large sample of the region's hotels.

As noted above, returns to the consolidated conglomerate are in fact much higher. Gaviota receives income not only from its hotels—many with five-star room rates—and other tourism activities and companies, but also from two other sources. One is its employment agency, which charges a 10 percent agency fee on the salaries that hotels pay to it (before those payments are exchanged from foreign currencies into Cuban pesos). The second is from its real estate holding company, Almest, which receives an estimated $80 million per year in leasing and maintenance fees from Gaviota's 63 hotels.[31]

In Cuba, in the case of a fully Cuban-owned hotel with no external management, all the profits would stay in-country. In the case of a hotel with a foreign management company, the amount available for repatriation is limited to its management fees, say 4 to 6 percent of gross operating profits. In our illustration, this would amount to $483,000 per year out of total revenues of $23 million, though negotiated performance premiums could increase this amount. In the event that foreign companies provide debt capital for construction, foreigners would also benefit from interest on debt. These can be lucrative. Industry sources indicated interest rates of 8 percent and repayment periods of five years were not uncommon.[32]

Altogether, for a typical hotel with a management contract, about 30 percent of revenues would depart Cuba via imports and fees; for a joint venture, the figure would be somewhat higher (depending on foreign equity share, reinvestment, taxes, and rent); the remaining revenues stay in Cuba. These estimates do not take into account the positive indirect effects on the economy, such as imported construction materials associated with initial investments. These numbers do illustrate the positive impact on the economy overall—and, more importantly, they illuminate expenditure categories where policy changes in Cuba could increase the positive effects of the industry on the economy (a point elaborated in the recommendations below).

These numbers are of course sensitive to average occupancy rates and average room revenues. For example, a 5 percentage point drop in occupancy rate is likely to reduce profits before taxes and interest to about 30 percent, assuming that hotel operating costs can be adjusted only partially in the short run. On the other hand, higher occupancy rates or stronger demand manifested in high average room charges would increase profitability.

Benefits for Workers: Labor Markets and Wages

Virtually all direct expenses for labor remain in-country. Industry experts suggest that 29 percent of expenses go to pay wages. In Cuba, hotels exclusively employ Cubans (hired through state em-

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[31] According to industry sources, hotels pay about $3,117 per room per year to Almest for leasing and maintenance fees, which when multiplied by 25,688 rooms yields the $80 million annual fee. By international standards this would undervalue real estate investments.

[32] As noted above, the SOEs building new hotels often solicit debt to cover construction costs, typically five-year term with interest rates of 8 percent.

Table 4. Typical Revenues and Costs in the Industry: An Illustration

		CUC (thousands)	Share of cost of item spent on imports	Foreign "leakage" as percent of revenue
Revenue	100%	22,995		
Expenses	100%	14,947		
Labor	29%	4,564	0%	0%
Food and Beverage	39%	6,246	66%	18%
Maintenance	7%	1,121	25%	1%
Utilities	14%	2,242	50%	5%
Marketing	6%	961	100%	4%
Other[a]	6%	708	25%	1%
Gross operating profit (% revenue)	35%	8,048		
Management contract @ 6% GOP		483	100%	2%
Profits before taxes & interest		7,565		
Return on sales		33%		
Percent of revenues spent on imports				31%

[a] Security, insurance, and miscellany

Source: Authors' estimates based on company interviews and secondary sources (see text).

ployment entities by law), except in the case of management contracts where perhaps half a dozen expatriates are employed, primarily in overseeing food and beverage operations. This important return to Cuban workers does not capture gratuities from tourists, which can exceed base wages by a multiple of ten or more; we spoke to workers who indicated that while their base wage was CUP 600 or $25 per month, they received tips in hard currencies of up to $300 a month during the high season. Other direct hotel expenses, such as maintenance and utilities (power, water, telecommunications), are paid to other state-owned enterprises.

An unusual characteristic of the Cuban economy is the labor contract system. Firms generally are not permitted to hire labor directly. Rather, a state employment agency (*entidad empleadora*, colloquially referred to as *bolsa empleadora*)—typically a dependency of the relevant sectoral ministry (for example, tourism, light industry, although Gaviota with 27,000 employees is large enough to have its own employment agency)—hires, fires, settles labor disputes, and establishes wage scales.[33] The hotel or tourist establishment will receive a list of approved workers from MINTUR from which the firm can make a final selection for a given position. In addition, MINTUR provides training for hotel employees, financed from the Ministry of Labor and Social Security.[34]

[33] Katheryn Felipe González, "A look inside Cuba's largest tourism enterprise," *Granma*, September 7, 2016.

[34] Richard E. Feinberg, *Open for Business: Building the New Cuban Economy* (Washington, D.C.: Brookings Institution Press, 2016).

The firm pays the wage bill to the state employment agency, which in turn pays the workers. The hotelier pays the agency in hard-currency CUCs at a given nominal wage, but the agency pays that same nominal wage to the workers in the form of much lower valued Cuban pesos. The effect on the company is to impose a huge tax on labor. The average monthly wage in 2014 in the category of "hotels and restaurants" was CUP 377, lower than the average wage of CUP 584 (this base wage would not include gratuities.)[35] If the firm pays the employment agency CUC 500 a month and the employment agency pays the workers an average of CUP 500, and taking into account the official exchange rate of CUC/USD 1: CUP 24, over 90 percent of the wage payment per employee slides into the state treasury; the effective compensation to the worker is instantly deflated to $21 per month.

In addition, firms pay a portion of their profits into a stimulus fund that is distributed as bonuses to employees. The Ministry of Economy and Planning negotiates the amount of the contribution with the Ministry of Tourism. Since the bonuses are paid in CUCs, they can add 30 percent or more to the wages of an employee. In addition, gratuities can exceed the base wage by several-fold. For example, a waitress in the VIP breakfast salon at a five-star Havana hotel reported earning tips of CUC 100 per month.

Benefits for the Economy: Local Purchases

Purchases from the local economy deepen the benefits of the industry. Most important are expenditures for food and beverage. A cursory survey of food and beverage offerings at several four- and five-star hotels in Havana and beach locations would suggest that a two-thirds/one-third division between locally-sourced and imported products would be a reasonable guess. Locally produced foods typically include some dairy and meats, fish and seafood (including lobsters), and seasonally available fruits and vegetables; local beverages include bottled water, some soft drinks and beer, and of course Cuban rum. Items typically imported include chicken (from U.S. vendors), some meats, yogurts and breakfast cereals, canned or frozen vegetables, and alcoholic beverages other than rum and local beers. These correspond to numbers reported in international trade statistics. If we assume a two-thirds/one-third split, 18 percent of hotel revenues would leak out of the country to import food and beverages for tourist consumption.

One reason direct benefits of the industry are lower in Cuba is because agriculture in Cuba has lagged behind comparable countries. A major constraint is supply, itself a reflection of low prices and imperfect access to modern inputs, such as fertilizer. Hoteliers complain that one of their biggest problems is securing fresh fruit, vegetables, meat, and fish for their restaurants. One reported: "Every day I have a fleet of trucks combing the island in search of food."

[35] ONEI, *Anuario Estadistica de Cuba 2014,* "Employment and Wages," Table 7.4. Wages are for state-owned and mixed enterprises. Surprisingly, wages in the hotels and restaurant sector declined from 465 in 2013 to 377 in 2014, whereas reported national average monthly wages rose from 471 to 584.

Since the 1959 revolution, agriculture has underperformed in Cuba. Reforms introduced tentatively in 2008, and then more boldly in 2012, permitted some price liberalization and private ownership, individually and via cooperatives, to occur. Uncultivated state land was opened up to private farmers and cooperatives. Farmers were permitted to market a portion of their crops—about 30 percent in 2013—after sales to the state run *acopia* (wholesale distribution system) for resale at subsidized prices. But restrictions on actual land use, compulsory sales at depressed prices, limits on use of labor, inadequate training of farmers, restrictions on access to modern inputs including fertilizer—all conspired to undermine the effectiveness of sectoral reform. Carmelo Mesa-Lago notes in his thorough review of reforms that by 2013 "with very few exceptions, all output indicators [were] well below 1989 levels" for agriculture.[36] This contrasts dramatically with agricultural performance in the neighboring Dominican Republic. Whereas in 2014 and 2015 Cuba exported a total of $650 million in agricultural exports, the Dominican Republic exported more than twice as much, $1.46 billion. Average annual food and agricultural exports in the Dominican Republic increased 26 percent in these two years relative to the average of 2011 to 2012, a time when they declined in Cuba by 14 percent. Moreover, the change in the structure of agricultural exports in these two once sugar-dependent economies is no less remarkable. In 2015, sugar still accounted for two thirds of agricultural exports in Cuba; in the Dominican Republic, it accounted for less than 10 percent.

One of the reforms introduced in 2013 was to allow sales by private farmers and cooperatives to the hotels and tourist sectors.[37] However, this welcome opening was undercut by the government's reversal of earlier price liberalization efforts and reintroduction of price controls to reduce the effects on urban citizens, if at the cost of effective rationing. Agriculture will likely suffer further with the new austerity measures. Fertilizer imports in 2015 were already only three quarters of their levels the previous year, and more constrained access to foreign exchange in 2016 will likely worsen the situation. Deepening this linkage between domestic agriculture and tourism could not only spur growth for the economy as a whole but would also help reduce rural poverty and maintain income equality in the face of market pressures leaning in the other direction.

Other expenditures in our illustration are maintenance, utilities, and marketing. Since major maintenance is the responsibility of the "owner"—the respective *inmobiliarias*—only lesser expenditures show up in these accounts, and virtually all of these are local expenditures involving local labor from the multiplicity of small construction service companies that have sprung up since the 2012 reforms. Their services can include repair of furniture, rudimentary plumbing, wall plastering, painting, and carpentry, among other things. Marketing fees are mostly spent abroad, and we assume here that only one third of expenditures is spent locally.

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[36] Carmelo Mesa-Lago "Institutional Changes of Cuba's Economic-Social Reforms: State and Market Roles, Progress, Hurdles, Comparisons, Monitoring and Effects" in *Cuba's Economic Change in Comparative Perspective*, ed. Richard E. Feinberg and Ted Piccone (Washington, DC: Brookings Institution, 2014).

[37] Ibid.

Domestic Tourism

Among the reforms enacted by Raúl Castro was to restore to Cubans their rights to access the beach and other hotels as well as restaurants and stores formerly reserved for international tourists. As incomes and remittances have risen, the use of the CUC spread outside the narrow confines of the tourist industry, and as the non-state sector earning in CUCs has expanded, national tourism (by permanent residents) has grown. By 2015, domestic tourism had become an important segment of the market, with revenues of CUC 310 million (of which CUC 138 million was for lodging, CUC 105 million for gastronomy).[38] Beach hotel operators now look to Cubans to fill their rooms in the summer off-seasons. While domestic tourism remains concentrated at one-, two-, and three-star establishments and at government camping facilities, overnight stays by permanent residents at four-star hotels reached 446,304 by 2014, while overnight stays at five-star hotels and resorts jumped from 129,656 in 2010 to 226,904 in 2014.[39] This domestic spending now constitutes a relatively small but nonetheless important and growing share of hotel revenues. It is an indicator of how the tourism industry can both spread wealth and be a beneficiary of the island's growing if still incipient prosperity.

Benefits for the Treasury: Capturing Resources for the State

SOEs as the Cash Cow for the Government

The government extracts resources from the sector to finance its recurrent expenditures in several ways. Taxes are one channel. Officially, the corporate income tax is 35 percent. The second channel is through a direct "*aporte*" of 10 percent for workers' benefits, which interviewees reported was taken off the top from gross operating profits. A third mechanism is through the implicit labor tax. As noted, the hotels pay the labor contract firm in CUC, but the labor contract firm pays the workers in CUP, so the difference after management fees of 10 percent to the labor firm amount to 87 percent of the wage bill of the sector accruing to the government. If the wage bill amounts to 18 percent of total costs as in our illustrative example above, the effective tax rate is 15.6 percent of costs in the sector.

A final mechanism for collecting revenue is through the dual currency and dual exchange rate system. The most transparent form is the currency conversion tax of 13 percent on all dollar transactions—though this does not apply to other currencies. The subtler version is through the multiple exchange rate system in which foreign exchange is made available to importing SOEs at subsidized rates. In recent times, the subsidies to importing SOEs in selected sectors, including in agriculture, involve purchasing dollars at 10 pesos (CUPs) instead of 1 peso (CUP), but the implicit tax/subsidy going to the state sector is substantial.

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[38] ONEI, *Turismo Nacional: Indicadores Seleccionados, Enero – Diciembre 2015*, July 2016. http://www.onei.cu/publicaciones/06turismoycomercio/indturismonacional/publicaciondic15.pdf. The ONEI report indicates that data was collected from the various state tourism agencies, suggesting that it might not capture revenues spent in the private tourism cluster. Many B&Bs rent to Cuban nationals under a government license that is distinguished from authority to rent to international visitors.

[39] ONEI, *Anuario Estadístico de Cuba 2014 Turismo, Edición 2015*, Tourism Table 15.6, "Overnight stays of domestic tourists in all accommodation facilities," http://www.onei.cu/aec2014/15%20Turismo.pdf.

Taxing the Private Sector

B&B operators must register with their municipal authorities as self-employed (*cuentapropistas*), and are subject to a series of taxes. Determining the actual tax burden, however, is difficult, and the Cuban government releases few relevant statistics. For many Cuban *cuentapropistas,* the effective tax burden is very much a function of the veracity of their reporting of revenues. In the absence of credit cards or some other reliable system to record sales, and the incapacity of the fledgling tax administration to properly audit returns, it is widely assumed that many firms grossly underreport revenues. In such cases, effective tax rates would be lower than the legal rates and in practice less of an oppressive constraint on business success than they might appear at first glance.

As with all self-employed enterprises, B&Bs face a number of taxes. These include a monthly licensing fee, social security taxes, and a progressive tax on net revenues (paid monthly and annually). Two small taxes are a progressive monthly licensing fee (*quota fija*) that must be paid regardless of revenues and contributions to the social security system. For example, one B&B owner in Havana reported that on her 43-square meter rental, which because of its prime location was renting at CUC 100 per night, the monthly licensing fee was CUP 720 ($30) and her monthly social security fee was CUP 78 ($3.26). By far the heaviest burden on B&Bs is the 10 percent tax on net revenues (*impuesto sobre la renta*) which must be paid on a monthly basis as a form of withholding tax, and then adjusted at year end (*declaración jurada*), which rises quickly from 15 percent on net yearly incomes of CUP 10,000 to CUP 20,000, to 50 percent on net incomes over CUP 50,000, equal to about $2,000. B&Bs catering to international tourists receive their revenues in CUC (which must be converted for tax purposes at the 24:1 official exchange rate); at 30 to 50 CUC per night per room, their annual revenues typically surpass the $2,000 mark and fall into the 50 percent bracket. In fact, the effective tax rate on profits could rise even higher, because the authorities place various limits on the deduction of costs from gross revenues.[40] Businesses can deduct from their gross revenues only 20 to 50 percent of costs, and some expenses are excluded from eligibility altogether. (However, only 50 percent of claimed expenses must be fully documented in tax declarations.)

There are also some smaller (some might say "nuisance") taxes. Businesses that wish to advertise their presence with signs or other commercial propaganda must seek permission from local authorities and pay taxes based upon the precise size of their advertisements. These taxes also vary according to district, ranging from CUP 30 per square meter per month in "urban service centers" to CUP 50 in districts "of high architectural value." Approvals cannot be taken for granted, as authorities, including the municipal or provincial zoning office, the Institute of Physical Planning (*Instituto de Planificación Física*), will weigh requests against the public interest.

For small businesses such as B&Bs, there is no payroll tax on the first five employees. However, the base salary upon which the payroll tax is determined rises with the number of employees: for 6 to 10

[40] Author interviews; see also Richard E. Feinberg, *Open for Business: Building the New Cuban Economy*, 158-160.

employees, the average base salary is set at 1.5 times the regional average salary; for employees 11 to 15, at two times the average salary; and for any additional employees the base rises to three times the average. This upward-sloping scale discourages business expansion and job creation (or encourages hiring off the books). At the same time, it is noteworthy that the tax code sets no limit on the number of employees.

Benefits for Future Generations: Protecting the Environment

As applied to tourism, sustainability encompasses a wide array of policy issues. Here's the way the Cuban Ministry of Science, Technology and the Environment (CITMA) defines "sustainable development":

> "The process of raising in a sustainable and equitable manner the quality of life of a population, harmoniously combining economic growth, social improvement, and environmental protection, such that the basic necessities of current generations are satisfied but without placing at risk the satisfaction of the necessities of future generations."[41]

In some aspects of sustainability, Cuba is off to an excellent start. Under the legendary leadership of Eusebio Leal, the renovation of *Havana Vieja* had honored sustainability criteria in several directions. Historical architecture has been preserved, alternative housing has been offered to displaced persons, and decent jobs have been created in construction, retail, and hotels. Local artisans and entrepreneurs are being given preference, at least so far, against the ubiquitous international luxury brands.[42] However, Habanaguex has recently been acquired by Gaviota, so it is too soon to say how the nation's largest hospitality chain will treat its historic assets.

Coastal development is a more mixed story. Among the all-inclusive resorts, we observed resorts that had preserved much of the natural habitat, including coastal mangroves, and whose architecture fit tastefully into the surrounding ecosystem. We also saw examples of ugly concrete boxes and barren landscape, stripped of greenery. We passed over long causeways that, contrary to some accusations, had not blocked the natural migratory patterns of sea life; rather, at every kilometer we found a bridge or wide tube to accommodate aquatic life.

Moving forward, Cuba has the opportunity to brand itself as a green tourism destination. Cuba already has extensive environmental legislation and a wide array of institutions (see Box 2). But as a remarkably self-critical CITMA study explains, these oversight institutions desperately need more resources, both qualified personnel and financial capacity. As the CITMA document also declares, international partners have been providing valuable assistance and would be welcome to contribute

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[41] CITMA, Plan for the National Park System 2014-2020 (Havana, 2014), 254. For more, see Box 2.

[42] Martha Oneida Pérez Cortés and Maidolys Iglesias Pérez, *Patrimonio y ciudadanía: Experiencias de participación en La Habana Vieja* (Havana: Ediciones Bolona, 2014).

even more. For example, the Environmental Defense Fund has been collaborating with its Cuban partners to preserve coral reefs and other marine and coastal ecosystems.

Box 2: *Plan for the National Park System 2014-2020:* Analytical Summary

Cuba created its first national park in 1930. Over the decades Cuba has established a system of over 200 national parks and other protected areas covering some 17 percent of its national territory. A comprehensive legal regime and corresponding implementing institutions—surveyed in detail in this planning document compiled by six ministries and 54 institutions—have been repeatedly amended and updated. Cuban authorities and scientists have dutifully mapped the island's national patrimony and biodiversity in rigorous detail, and fully comprehend the many rationale—socio-economic, climactic, cultural, trans-generational—for their preservation.

The CITMA document contains this definition of "sustainable development" (p. 254):

"The process of raising in a sustainable and equitable manner the quality of life of a population, harmoniously combining economic growth, social improvement, and environmental protection, such that the basic necessities of current generations are satisfied but without placing at risk the satisfaction of the necessities of future generations."

In 1994 the government created the equivalent of a ministry of the environment, CITMA, and in the following year the Center for National Parks (CNAP), now under the aegis of CITMA. Together with the Ministry of Agriculture, CITMA through the CNAP administers the national park system (SNAP). Characteristic of Cuban governance, the national park system is overseen by an Inter-Agency Committee for National Parks integrated by eight government agencies, including CITMA, the National Company for the Protection of Plants and Animals, and the armed forces.

As with many Cuban government planning documents, the SNAP plan is replete with a very long list of goals and objectives. For 39 dense pages, the document lists planned activities paired with the responsible agencies. Nevertheless, most goals lack quantitative targets (although one stands out: 80 percent of the national park acreage is to be planted with trees (p. 215)).

Two other flaws common to such planning documents are notable. Priorities are not clear: of these many goals and objectives, which ones merit the attention of senior officials? And most disconcerting, rarely does the document estimate financial costs. Nor is there much discussion of sources of funds. The planning document is much better at compiling lists of desirable outputs than it is at budgeting.

However, the SNAP planning document is remarkable in one important respect: it is devastating in its frank criticism of the failures to accomplish the goals of previous planning exercises. Principal problems identified during the implementation of the plan for 2009-2013 include:

- More than half of the protected areas suffered from a complete lack of administration. A survey of 52 protected areas found that 79 percent suffered from a shortage of equipment, 64 percent from shortages of transportation;

- Technical capacity has been lacking to formulate operational plans or to undertake monitoring and evaluation;
- The number of inspectors has been insufficient to ensure enforcement of regulations;
- Statistics are often inadequate and if collected arrive too late. Information gathered from pilot projects are not well integrated into future planning.

Overall, “these problems are present in the majority of protected areas due to financial difficulties.…” (p.100). However, international cooperation has helped to fill the gaps in financing and training, supporting approximately 51 percent of the protected areas.

The CITMA document contains a section, albeit of only two pages, on “sustainable tourism” (p. 232-233). Again, the authors candidly explain previous failures: few products are genuinely sustainable tourism; products are not well customized to specific markets; and the absence of mechanisms to reinvest tourism revenues in resource conservation and in improving the quality of life in local communities.

Source: Authors’ summary; Ministry of Science, Technology and the Environment (CITMA) (2013).

Section 5. Realizing Cuba's Goals for Tourism Growth: Investment Requirements

To meet the government's stated objectives of tripling tourism revenues by 2030, the government has adopted the goal of adding some 108,000 rooms to the existing hotel stock of 50,000 rooms of three-star quality or better using Cuban standards. This would accommodate as many as 10 million visitors (not including cruise ship tourists). To accomplish this ambitious real estate investment goal, we calculate Cuba will require roughly a total of $33 billion in new investment over the 15 years to 2030—a massive sum in comparison to the overall size of the Cuban economy or its current investment rates (Table 5).

The sum of $33 billion includes an investment of nearly $22 billion in new rooms, and cumulative depreciation of $7 billion. Industry sources estimated that costs of construction typically run $200,000 per room for a four-star hotel. To this we add the costs of renovating "out-of-order" rooms in 2015 (which industry sources estimate to be today about 10 percent of the total) over a five-year period, or $200 million. We also assume that some 5 percent of the three star or better rooms need refurbishing annually to a cumulative cost by 2030 of $1.2 billion. Finally, we add the costs of infrastructure hook-ups for new hotels—roads to highways, piping to utilities, and the like. Industry sources typically add some 15 percent to the cost of each room, adding another $3.2 billion to the total costs of reaching the goal of an additional 108,000 rooms.

Under these assumptions, investment in the tourism industry would amount to about $1 billion in 2016, rising steadily to about $3.9 billion per annum in 2030. If the economy were to expand at the same rate of growth as the 2011 to 2015 period on average – that is, 2.8 percent annually – and investment were to hold constant at today's rate of 10 percent of GDP, the sector will absorb an increasing amount of all national investment, rising under our assumptions from one sixth of all investment to one-third.

In fact, investment of the whole economy—and savings to finance it—would likely have to rise substantially to build the industry as the government would like. The government cannot afford to

Table 5: Meeting Cuba's Investment Objectives Will Cost a lot Over the Next Fifteen Years

	2016	2030	Cumulative
Number of rooms, 3-stars and above, current stock plus new projected	53,986	158,000	108,000
Investment Requirements (USD, thousands)			
Cost of new rooms ($200,000 each)	797,233	2,333,242	21,600,000
Depreciation (new rooms)[a]	39,862	1,080,000	7,126,856
Renovation "out of order"[b]	40,000	–	200,000
Refurbishment of 5 percent of stock annually[c]	43,189	126,400	1,170,148
Infrastructure connections (adds 15 percent of room cost)	119,585	349,986	3,240,000
Total	**1,039,868**	**3,889,629**	**33,337,004**
Memo:			
Share of GDP[d]	1.3%	3.3%	
Share of Investment	13.1%	33.4%	

[a] Assumes 20 year life of building
[b] Assumes 10 percent of 2015 initial stock requires renovation and is undertaken over five years
[c] Assumes 5 percent of 3-, 4-, and 5-star hotel stock of 2015 is refurbished annually at a cost of $16,000 per room
[d] GDP is assumed to grow 2.8 percent annually (i.e., 2011 to 2015 average), and investment holds constant at 10 percent of GDP
Source: Authors' calculations based on cost estimates from industry experts; GDP and investment rates come from Cuban national accounts.

double the industry's share of national investment at the expense of other badly needed sectoral investments. In addition, these numbers do not account for various indirect investments necessary to accommodate this expansion in tourism capacity: related expenses would include infrastructure such as electrical power generation and transmission, water and sanitation, telecommunications and internet facilities, as well as the expansion of airports and docking facilities for cruise ships and other water-born craft. Nor do these numbers include other costly proposed tourism facilities such as marinas and golf courses, nor the maintenance and upgrading of national parks and wildlife reserves for eco-tourism. Collectively, these infrastructure and other indirect investments would add substantially to the direct investment requirements—and imply a needed increase in the overall investment ratio, now at 9 percent of GDP and well below Latin American averages of 21 percent.[43]

Financing Strategy: Is it Viable?

In announcing its tourism expansion strategy, the Cuban government has not released a strategy whereby its plans would be financed. This absence of accompanying financial projections is all too common for a government still accustomed to the "material" (e.g., goods rather than financial) balances that dominated Soviet-style central planning exercises. However, as noted above, given that

[43] From World Development Indicators, averages for data available since 2011.

some 70 percent of the new rooms will apparently be undertaken by SOEs without external equity, and the 30 percent of joint ventures will be majority owned by Cuban SOEs, it appears that Cuba plans to finance the lion's share of this tourism expansion with its own retained earnings, perhaps in combination with short term debt from management companies.

If Gaviota, the biggest SOE, maintains its 40 percent share of available rooms and Cuba realizes its goal to add 108,000 rooms by 2030, the company would supply 43,160 new rooms. In Havana, it will add just 7,000 new rooms between 2018 to 2025, a fraction of its plans along the island's beaches and bays.[44] For example, Gaviota will own the luxury 246-room five-star Manzana de Gomez hotel occupying the historic Gómez-Mena building complex, contracting the Swiss hotel chain Kempinski to manage the flagship enterprise. Gaviota will also develop the prized properties of the Prado y Malecón (with the French chain Accor) and Packard hotels.[45]

The company has indicated it will build hotels and operate them via management contracts with foreign managers. Joint ventures would involve profit-sharing, and Gaviota would prefer to limit its foreign partners to management contracts that require the partner to take responsibility for international marketing to ensure profitable occupancy rates. Gaviota may be able to generate sufficient internal cash flow to finance the hotel expansion; the expansion plans of the other SOEs might depend on allocations from the central government.

This strategy of relying on retained earnings may make sense from the perspective of the sectoral conglomerates, but as discussed in the following section, given the foreign exchange constraint hobbling the economy, it seems unlikely that sufficient financing and domestic savings would be available to reach Cuba's ambitious goals.

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[44] País Oltuski, FITCuba 2016. The Gaviota representative stated that "today Gaviota operates (in Havana) 1,294 rooms," and added that in the whole country "today the group has 62 hotels and villas operating with 26,752 rooms."

[45] In fact, much of hotel construction in Havana will consist of refurbishing old hotels, a process already under way. With a few notable exceptions (Havana Libre, Riviera), these urban classics, typically in the range of 100 rooms or less, are much smaller than the 500-plus room beach resorts. Claire Boobbyear, "Cuba's Hotel Challenges: A Guide to All the Projects in Process," *Skift,* September 6, 2016.

Section 6. Conclusions and Policy Recommendations

Policy Options for Cuba: Harnessing the Industry to Raise Incomes

Cuba has laid the foundations for potentially rapid growth of the tourism sector. The country has abundant tourist attractions, undeveloped natural resources, and a welcoming culture that make it a jewel in the Caribbean Greater Antilles. In addition to the dominant urban and beach tourism, the government is planning diversified tourism offerings including medical tourism, eco-adventurism, aquatic sports and boating, and even culinary tastings and revolutionary reenactments (following in the footsteps of Fidel Castro in the Sierra Maestra) (Annex C). The government has laid out ambitious plans to 2030. Moreover, its strategy of aspiring to move up the value chain by increasing domestic value added promises to convert the industry into a driver of growth. Cuba's hotel chains, construction firms, and small private contractors have developed capabilities that could contribute to export earnings by offering their services abroad. However, achieving its objectives requires tackling key obstacles to the sector's growth—and to the growth of the economy along with it. Cuba can shape the growth patterns and product mix of its tourism industry in ways that promote badly needed structural economic reforms.

Financing

With the recently announced austerity measures to cope with the foreign exchange rate crisis, financing will become even more constrained than in the past. Realizing the desired level of investment—given the constraints of the current policy framework and available sources of finance—would probably add to the strains already evident in the economy, rather than relieve them. Said differently, the objectives of the government are reasonable—and attainable—but they will likely require adjusting the current policy framework to open up new sources of investment finance. It seems very unlikely that the government can mobilize the $33 billion necessary to achieve its objectives without creating severe and unsustainable pressures elsewhere in the economy.

While Gaviota has a huge cash flow and can finance much of its internal resources through retained earnings, this misses an opportunity to leverage the industry's foreign exchange generating capacity. As a consequence of all of these income streams, Gaviota apparently believes that it can finance its planned expansion from internal cash flow (occasionally supplemented with medium-term construction loans from its foreign management partners). Rather than seek to fund these investments through the internal cash flow of the tourism sector, it would make more sense—from a national interest perspective—to welcome greater foreign equity and debt financing, and to extract some sectoral resources to finance other national needs, including building much needed infrastructure and upgrading social services. The government has several powerful instruments to regulate the sector's development and to extract resources for the rest of the economy, so it no longer needs to maintain a controlling equity interest in selected enterprises. It does need to replace existing forms of implicit taxation with explicit modern forms.

Removing Bureaucratic Obstacles to Investments

If the tourism industry is to benefit from foreign capital inflows, Cuba will have to revise some of the impediments to foreign investment that have choked off most foreign investment projects across the island. Cuba's foreign investment laws and its taxation provisions fit international norms and are not a major impediment to international investment. Rather, the major hurdle has been the bureaucratic approval process—opaque, prolonged, and multilayered. Except for some minor ventures where approval at the ministerial level might suffice, foreign investments must gain the approval of a pyramid of bureaucratic players that culminates at the very top of the Cuban hierarchy, by the Council of Ministers or the Council of State. President Raúl Castro personally signs off on major projects. Thus, there has emerged a very wide gap between the government's oft-stated goal of attracting foreign investment and its ability to approve and implement concrete projects.[46]

In the tourism sector, the government has advertised a wide range of potential hotel and resort projects in its annual release, "Portfolio of Opportunities for Foreign Investment."[47] Many foreign investors have long expressed strong interests in many of these opportunities, but the number of approvals is stalled at a small fraction of the number of officially advertised opportunities. The delays obey a number of deep-seated drivers, including bureaucratic red-tape, weak incentives facing bureaucrats to speed authorizations, and residual ideological distaste for international tourism. In order to take full advantage of the availability of international finance, the government will have to work more systematically and urgently to relax each of these constraints.

Encouraging Private Investment

The private B&Bs offer a potential model of success: B&Bs have attracted sizeable foreign and domestic savings while maintaining legal ownership by domestic Cubans. Remittances, loans, and even small-scale investments from private parties abroad have driven a flourishing national indus-

[46] Feinberg 2016, especially chapters 4-5.

[47] For the 2015 version, see the *Cuba Portfolio of Opportunities for Foreign Investment 2015*, http://www.granma.cu/file/sp/cartera-de-oportunidades-de-inversion-extranjera-23/datos/documentos/Portfolio%20of%20Opportunities%20for%20Foreign%20Investment%202015.pdf; pages 89-113 list proposed tourism projects including 97 hotel management contracts, 25 hotel development projects, and five management contracts for marinas.

try. Foreign savings have increased total investment in product offerings that create good jobs and national wealth.

Encouraging private investment in B&Bs would open new sources of foreign exchange and should be a priority. At present, these transactions are generally informal and so the government has neither the benefit of full tax value nor a firm idea of the actual ownership of properties. One simple but far-reaching reform would be allowing Cubans to legally own more than one private dwelling. A complementary reform would be modernizing and simplifying the tax structure facing private firms and property owners, lowering the frequency of reporting, automating transactions linked to the banking system, and introducing a property tax.

For some period of time, the government may wish to maintain the general prohibition, with some exceptions, of non-Cubans from owning property. Notwithstanding recent increases in prime locations, the values of housing and property are well below international markets and so premature liberalization would risk alienation of broad swaths of major Cuban cities to foreign ownership in exchange for one-time capital inflows.

One way to facilitate access to foreign finance while preserving domestic ownership would be to set up a quasi-mortgage market with a correspondent bank that would sell bonds or commercial paper in the United States or in Europe to provide long-term finance to housing renovations in Havana and elsewhere. The currency mismatch risk would be offset because of the investment in an export activity (B&Bs), and the bank could take as collateral the property itself, to be later sold to other Cubans in event of default. Interest rates would be far lower than informal rates that Cuban domestic home owners and would-be B&B owners currently have available for construction finance (if at all). Such a mechanism would allow Cubans to maintain ownership over their domestic assets, markedly increase foreign inflows into the industry, and allow the society to retain the capital gains during the period of adjustment to international prices. It would also allow today's informal and sometimes illegal market to become legal and transparent, allowing the government to set market valuations for an eventual property tax.

Raising the Gains to Cuba

The Cuban government has indicated that it wishes to improve the overall quality of its offerings and attract greater revenue per tourist, much as other countries in the region have done.[48] To date, Cuba has focused on "value" tourism in low-cost, all-inclusive beach resorts. Among tourism classes, there are large differences in the average daily room rates (ADR). For example, the U.S. market rates reflected in Table 6.

[48] Marrero, FITCuba 2016.

To date and for the most part, Cuba has in effect been serving the lower three categories, catering to value-seeking tourists from Canada and Europe. But with the prospect of greater demand associated with U.S. tourists, the government has recognized that it has to improve the quality of its offering and target upscale and luxury accommodations. This means investing in better quality of facilities and service, which in turn requires more staff training, upgrading its food and beverage services, and keeping its physical plants in better working order. None of these challenges is insurmountable, but they will require a realignment of incentives facing management and the allocation of more investment resources to worker training and building maintenance. Fundamentally, management will need to focus more on client service—and be rewarded for doing so. For the tourism industry as a whole—especially the large SOE groups—this will mean a shift from price competition to quality and brand competition.

Table 6. The U.S. Market Has a Wide Range of Average Daily Room Rates

Room Class	Average Daily Room Rate (USD)
Luxury	322
Upper Upscale	183
Midscale	81
Economy	58

Source: STR, "Weekly Hotel Review," 2015

Underpinning this strategy is a need to reconsider its investments in large hotels and resort complexes catering to up to 500 to 1,000 visitors at a time. Looking forward, Cuba might do better to dot the island with smaller, more customized destinations. Smaller establishments can offer an eco-friendly and authentic experience, a differentiated tourism product that creates a comparative advantage over other destinations. At the same time, the large enclave resorts also rely more on large-scale standardized imports for some of their input requirements, for example in food and beverages and furnishings. In this regard, the Dominican Republic and Costa Rica offer strategic direction. The average number of rooms per establishment in 2012 in the Dominican Republic was 96 and in Costa Rica the number was only 18. For Cuba, the average number of rooms per establishment was 150.

Up-grading Service Quality

Service in Cuba, though improved in many locations, will have to improve significantly to achieve four- and five-star caliber at international standards. Jobs in the tourist sector are prized because of their access to tips and better working conditions. Even so, the lack of wage flexibility and full managerial discretion to promote, hire, and fire conspire to deprive hotel managers of important tools to increase service and productivity.

Because of the labor contract system, hotel workers have a dual loyalty: to the hotel management, and to the employment agency. The employment agency's representatives supervise and evaluate hotel workers' performances, determine wage scales, and directly pay the monthly salary, and would have final say on any firing or transfer to another tourism property. In the case of joint ventures or international management contracts, the number of expatriates is only three to six personnel (a general manager, and managers in food and beverage, accommodations, and entertainment); Cuban employees look to those expatriates for day-to-day guidance and skills acquisition. One savvy long-term employee at the Melía Cohiba in Havana remarked: “I work for Cubanacán, it pays me my wages. Melía are just external advisers.”

This unusual dual hierarchy depletes the authority of senior hotel management. It may also reduce their incentive to invest in worker training, as they lack control over incentives to motivate workers (wages, promotions, future placement). In our interviews with hotel management, all managers emphasized their attention to training their personnel. But few seemed to have a rigorous training plan in place. If Cuba is to upgrade the overall quality of its tourism offerings, it is obvious to experienced travelers that the Cuban hospitality industry will have to invest more in staff training. To provide better service, hotels will also have to raise the ratio of employees to guests—an important indicator of service quality—and accept that better service generally requires more operating costs per guest. The recent leap in hotel prices provides ample scope for both higher profits and more expenditures on service quality.

Deepening Domestic Linkages

The government has barely tapped the potential of the industry to provide a stimulus to growth throughout the economy. One sector waiting to contribute more is agriculture.

The current devil’s choice between allocating food for tourists or food for Cubans is unsustainable if the tourism industry is to become an engine for growth that will benefit all Cubans. A better policy combination is to begin to progressively liberalize prices in agriculture, coupled with other pro-growth reforms, to create incentives for farmers to produce food, and to mitigate effects in cities on the urban poor through direct and targeted subsidies via the ration-card system. During the transition to a more productive agriculture, phasing out the dual currency/dual exchange rate system will require maintaining some subsidies for imported agricultural inputs in the context of a program to phase them down over time.

Spurring Connectivity

Cuba has already taken steps to better connect the Cuban economy to the rest of the world through its incipient efforts to expand internet, telephone services, and air connections. Even so, Cuba’s internet access per person is among the lowest in the world and far below Cuba’s level of per capital income. Yet the internet is central to the development of the tourist industry. Consumers—both for business and leisure travel—increasingly look for connectivity as a condition of a quality vacation, and businesses need it to permit bookings, engage in marketing, and even to settle foreign accounts.

The government has also begun negotiating with American telecommunications companies to expand coverage to Cuba. In September 2015, it began to offer roaming service in Cuba, via Vodaphone, but launched through its own network in March 2016. Sprint soon followed suit in November

2015, and later expanded service in April 2016. In August 2016, AT&T entered into an agreement with Empresa de Telecomunicaciones de Cuba (ETECSA) to offer direct mobile roaming interconnections. These would permit talk, text and data transmission.[49] Even so, internet access and mobile phone access remain sporadic, expensive, and of sub-standard quality by international norms.

Similarly, the availability of air transport connections is central to the development of the industry.[50] As part of the bilateral rapprochement, the United States and Cuba reached an arrangement to establish regularly scheduled air services, beyond the charter flights already available between the two countries. During the summer of 2016, the U.S. Department of Transportation approved six U.S. airlines to begin flights between five U.S. cities and nine Cuban cities and up to eight U.S. airlines to service connections between Havana and 10 different U.S. cities.[51] Totaling as many as 110 weekly round-trip flights, U.S. airlines could eventually add over one million seats annually to traffic between the two nations.

Fiscal Policy: Capturing Rents from the Sector

Because tourism is a major source of foreign exchange earnings and growth, the state must capture a share of its revenues to finance investment elsewhere. At present, the state inefficiently captures these resources through the dual currency and multiple exchange rate systems, which in effect tax exports and subsidize imports; through the labor payment system that allows the labor company and state to cream off an exorbitant wage tax; through state ownership of the sector; and through direct taxation. All but the last instrument involve self-defeating distortions. However, they cannot readily be undone until more modern forms of taxation are put into place.

The 2011 reform guidelines looked forward to a unification of the multiple exchange rate system. Unfortunately, this vital reform was repeatedly delayed and now, in the midst of a foreign-exchange shortage, implementation becomes more difficult. The current system, by effectively taxing exports massively and subsidizing imports, exacerbates the current account deficit—the reverse of what is needed to overcome the foreign exchange constraint. It ultimately results in inefficient administrative rationing.

Augusto De La Torre and Alain Ize have outlined four options for reform.[52] Their favored option is what they call a "fiscally-cushioned big bang" strategy for exchange rate unification. This immediate unification of the multiple rates and dual currency into one, coupled with transitional lump sum taxes on firms earning CUC and subsidies to any enterprise purchasing in CUCs; these transitional taxes and

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[49] "ATT to offer direct Roaming to Wireless Services in Cuba" *Yahoo*, August 23, 2016, http://finance.yahoo.com/news/t-offer-direct-roaming-wireless-143802312.html.

[50] One study for the Caribbean found that "…increasing the number of flights is found to be the most effective way to boost tourist arrivals on a sustained basis." Sebastian Acevedo, Lu Han, Hye Sun Kim, and Nicole Laframboise "Flying to Paradise: The Role of Airlift in the Caribbean Tourism Industry" IMF Working Paper WP/16/33 (Washington, DC: 2016).

[51] U.S. Department of Transportation, "Fact Sheet – DOT Issues Order Approving U.S.-Cuba Service to Cities Other Than Havana," https://www.transportation.gov/sites/dot.gov/files/docs/CubanonHavanaFactSheet.pdf.

[52] Agusto de la Toree and Alain Ize "Exchange Rate Unification: The Cuban Case" in *Cuba's Economic Change in Comparative Perspective,* ed. Richard E. Feinberg and Ted Piccone (Washington, D.C.: Brookings Institution, 2014).

subsidies would then be phased out over a few years. In fact, the proliferation of CUC transactions throughout Cuba in the time since they studied this transition may have speeded the adjustment of relative prices. Still, the domestic price level is well below international prices for many comparable goods and services, and forces the system into administrative allocation and de facto rationing.

From the vantage of the tourism industry, a first order of business is therefore to put in place the elements of a modern tax system that would effectively replace the implicit exchange rate tax. As with other export industries, the tourism industry stands to gain from any form of unification at some rate between 24 pesos to the U.S. dollar and 1 peso to the U.S. dollar. If the new rate of pesos to U.S. dollars were to be, say, 10, unification would imply that firms in the sector would earn 10 pesos for every dollar, and be able to record immediate windfall gains. Taxing these back and using them to cushion the adjustment of the importing sectors (such as energy and parts of domestic agriculture) and providing resources to the treasury would ease the adjustment during the transition to international relative prices.

A new more efficient tax system—which would incentivize growth and provide resources to the government for productive investments and higher-quality social services—could include a value-added tax (VAT) on the hotels and tourist services, a withholding tax on personal income for all employees in the industry (as the government is initiating on a country-wide basis for state employees), and a property tax on assets which would allow the state to recoup some investment on its infrastructure provision as properties appreciate. A property tax would be particularly important. At present, reported payments for leasing property and lands appear to massively undervalue their true worth. Moreover, as incomes in Cuba rise, so too will the value of urban and beach properties. A land and building tax system can capture part of these rising values for the government, and these buoyant revenues provide funds for expansion of much needed infrastructure.

Even though austerity is now the rule of the day, the boom in tourism offers the opportunity for beginning to extract the enormous potential rents from the industry—but not so drastically as to kill the golden goose—and to channel these into productive import-substitution and foreign exchange saving activities, such as agriculture, selected light manufactures, and efficient energy production.

Taxing the Private Sector

Not accustomed to having to collect taxes on a large number of private entities, the tax authorities badly need to augment their collection and auditing capacities and to computerize what is still largely an antiquated paper process. A broader tax base would allow for more revenue and lower rates. A smart tax regime should discourage informality and tax evasion—unlike the current high rates which stimulate under-reporting of revenues—and encourage honest reporting and taxpayer participation, and incentivize investment and job creation.

To encourage this promising feature of Cuba's tourism future, the government should reconsider the tax regime that governs B&Bs, and alter the payroll taxes to encourage, not discourage, job creation.

Otherwise, as their businesses grow, the owners will be tempted to keep workers in an informal off-the-books status, out of sight of tax authorities but also unprotected by government labor standards.

The authorities, including MINTUR and MINTRAB, could also encourage a certification program that ensures tourists that their lodgings are safe and sound. A useful precedent: the Costa Rican Certification of International Tourism, with its multi-stakeholder governing board.

Sector Organization: Improving Productivity

A central objective of the current Cuban leadership is improving the management and efficiency of the tourism sector. The abundant literature on transitional economies and state owned enterprises highlights the roles of incentives at all levels of the enterprise in solving the principal-agent problem afflicting all corporate governance: incentives facing owners, managers, and workers.[53] Several elements contribute to incentives that encourage productivity growth: competition, hard budget constraints, enterprise and managerial performance contracts, and well-functioning oversight institutions.[54]

Within the tourism sector, policy reforms opening selected services–restaurants, B&Bs, taxis, and construction/remodeling–to private or non-state competition have provided new competition to SOEs in some segments of the economy. By all accounts, not only has employment increased in these activities but so has the quality of service. Because the large tourism conglomerates face competition through the international markets, their performance is somewhat easier to measure, at least in the aggregate (as shown by the data in this report).

The recent economy-wide efforts to reorganize the large state conglomerates by placing them within holding companies may also be indicative of efforts at decentralizing management, insulating companies from political interference with managerial decisions, and establishing hard budget constraints.

Areas where incentives do appear well aligned to maximize productivity concern the foreign management of the hotels. Management contracts contain incentives for better performance, and state enterprise owners meet regularly, typically monthly and quarterly, with the senior management team to review performance. This alignment of incentives has been found to work in many other developing countries—in part because competition in the industry reduces the information gap that owners would otherwise suffer relative to managers. Moreover, many of the major hotels often prefer management contracts because their long-run financial exposure in buildings and installations is

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[53] In advanced market economies, where large public corporations have hundreds of thousands of owners owning small shares, the interest of dispersed share-holding owners (principals) may diverge from managers (agents) who actually control the company (Oliver E. Williamson, *The Economics of Discretionary Behavior: Managerial Objectives in a Theory of the Firm*, (Englewood Cliffs: Prentice-Hall, Inc, 1964)). In an economic system dominated by state enterprises, an analogous problem arises in that managers (agents) have information that supervising entities and government authorities (principals) do not, and their interests do not always align.

[54] World Bank, *Bureaucrats in Business: The Economics and Politics of Government Ownership* (World Bank: Washington, D.C., 1995).

minimal. Even if they have put up debt capital during construction, the payback periods are usually short. This allows them to focus on their strengths—management, marketing, and service.

Incentives facing labor and property management are less well aligned to encourage increases in productivity. (Labor is discussed above.) The division between property owners (the *inmobilaria*) and the operators means that maintenance receive short shrift. While the operators can undertake small expenditures for maintenance (e.g., painting a room), the owner is responsible for larger expenditures (such as elevator maintenance). Because payments for use of hotel property are too low, maintenance budgets for a hotel group typically are exhausted before the year is out. Moreover, because each large capital budget item has to be included in the national plan, frequently there is no recourse for broken pieces of equipment until the following year.

Two other factors inhibit government oversight of the state sector that would otherwise motivate strong firm-level performance. First, the absence of reliable market signals throughout the economy–particularly for foreign exchange–and the corresponding prevalence of administrative allocation, rationing, and extensive cross-subsidies means that the profitability and measures of labor productivity are unreliable guides about performance. Second, the absence of published and audited financial accounts means that members of the economic cabinet have no independent way of verifying the performance of subsectors of the economy, much less comparing it with other international performance indicators. In addition to moving more purposefully toward exchange rate unification, a long-expressed goal of government, Cuba could introduce the practice of modern and transparent corporate accounting so as to facilitate oversight.

Enhancing the Environment and Cityscape

Certification programs are a means of raising standards and providing assurances to consumers. Costa Rica's tourism board, for example, offers its Certificate of Sustainable Tourism, ranking tourist establishments by its five-star system, based on audits—whose results are posted on-line— that consider a range of criteria, including community relations, labor practices, and environmental stewardship.[55] The popular travel website TripAdvisor.com is already pushing hotel managers to raise standards; we were told by several hotel executives that they regularly review customer comments.

Outside of Old Havana, much of the rest of Havana (population 2.1 million) is also likely to witness major renovation or wholesale reconstruction. Optimistically, this offers an historic opportunity for city planners and architects to get it right, for Cuba to live up to its reputation of being "The Pearl of the Caribbean." But will local institutions be able to resist the commercial appetites of the hordes of international real estate developers and speculators that will likely be descending upon the island?

[55] Richard E. Feinberg, *The New Cuban Economy: What Roles for Foreign Investment?* (Washington, D.C.: Brookings Institution, 2012), 72. The website of the International Ecotourism Society (http://www.ecotourism.org/) offers a compendium of certification programs.

Too many cities in developing countries have succumbed to these “market” forces, often in league with corrupt local officials. To avoid such a calamity, we propose three policy innovations:

- Cuba should not in the short run open its private residential real estate market to foreign investors to avoid speculative bubbles and overbuilding, and to give domestic institutions time to develop strong oversight capacity and allow Cuban nationals to profit from the rising property values likely associated with greater integration into the international markets. Exceptions could be made for indirect foreign investment in B&Bs with adequate intermediation along the lines of the quasi-mortgage arrangement suggested in the previous section .

- Cuba could name an international advisory board of city planners and architects. Why not marshal the world’s best-and-brightest—many of whom would rush to serve—to offer their expertise, which would be non-binding but carry moral weight? If it were the government that requested such advice and carefully circumscribed its authority, Cuban national sovereignty would not be compromised.

- Cuba should establish a transparent process of bidding for its larger building projects, and post bids and results on-line. This would reduce opportunities for insider deals and outright corruption, and provide assurances to citizens that the national interest was being well protected.

Recommendations for Government, Industry and Non-Profits

Decisions made in Cuba will, appropriately, drive the growth of its tourism industry. But there are several measures that the U.S. government, in its own national interest, could take that could help spur both strong growth and sustainability in the industry.[56]

Supporting Economic Reform in Cuba

The Cuban government and people will decide on the pace and direction of their economic policies. If asked, and sensitive to Cuban sovereignty, the United States should be prepared to assist. Bilaterally, the United States can offer technical assistance as it has begun to do through the bilateral “regulatory dialogue.” If the U.S. government continues to relax its economic sanctions, its economic sanctions, the United States could also offer to provide official credits and credit guarantees through the Export-Import Bank, Commodity Credit Corporation, and Overseas Private Investment Corporation (OPIC), provided that the Cuban authorities can meet the requisite conditions. Like any financial institution, these entities hesitate to take on risk, yet they must keep in mind that as official agencies they were created precisely to enter markets where the private sector fears to tread.

The comprehensive Presidential Policy Directive (PPD)-43, issued on October 14, 2016, affirmed that the United States seeks Cuban government participation in regional and international fora.

[56] For a list of recommendations with applicability to the tourism sector, see Geoff Thale and Sarah Kinosian, “Twenty Ways that President Obama can Advance U.S.-Cuba Relations,” *Washington Office on Latin America (WOLA)*, September 2, 2016, https://www.wola.org/analysis/20-ways-president-obama-can-advance-u-s-cuba-relations/.

Consistent with this proposition, the administration signaled to the international financial institutions and to the Cuban government that the United States will not stand in the way of Cuban engagement with the international financial institutions, notably the World Bank, International Monetary Fund, and Inter-American Development Bank. U.S. legislation places certain restrictions on U.S. support for Cuban membership and borrowing in the IFIs, but the executive branch has sufficient room to maneuver to permit Cuba to find a step-by-step pathway to seeking technical assistance and eventually membership in the IFIs.[57] The Cuban government, however, must signal its interest in initiating a process toward IFI membership.

U.S. Citizen Travel and Finance: Ending the Embargo

The Obama administration liberalized travel for both Cuban-Americans and other American citizens, but the latter are still required to fit their travel into one of a dozen "purposeful" categories intended to build people-to-people exchanges. Legislation pending in the U.S. Congress calls for full liberalization of travel.

The restrictive guidelines have created an industry of tour operators offering cultural and educational itineraries, which not only enrich the experiences of U.S. travelers but also spread the benefits of tourism more widely in Cuban society. We judge that this valuable people-to-people infrastructure will likely survive the full liberalization of U.S. travel.

The Obama administration sought to allow U.S. travelers to have access to normal credit card usage in Cuba, but the commercial banks that manage the financial transactions have hesitated to enter the Cuban market, fearing either U.S. government sanctions or political backlash among hardline Cuban-Americans. The next administration could work closely with the banking community to overcome these barriers so that U.S. tourists can enjoy the financial security of making use of their credit cards while in Cuba.

To accommodate a continuing surge in U.S. visitors, the U.S. Embassy in Havana would need sufficient personnel and resources to provide basic services. But the U.S. Congress has blocked administration requests to beef up Embassy services, placing U.S. citizens at risk. The Congress should drop those objections and support the administration requests for enhancing the capacities of the U.S. diplomatic mission in Cuba.

Notwithstanding some relaxations, the core of U.S. economic sanctions remains in place. In the meantime, there are specific measures that could be taken in the tourism sector. Under President Obama, the administration authorized important elements of the U.S. travel industry, including commercial airlines and passenger ferries, to enter the Cuban market. Working with the Cuban government, the U.S. government has authorized flights not only to Havana but to many other airports

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[57] Richard E. Feinberg, *Reaching Out: Cuba's New Economy and the International Response* (Washington, D.C.: Brookings Institution, 2011).

around the island, encouraging a more balanced expansion of the tourism industry that spreads the benefits around the island. We applaud this forward-looking approach.

Furthermore, the U.S. government could provide a general license for U.S. firms to engage in commerce and to invest in the tourism sector, broadly defined to include not only hotels and resorts but also tourism-related infrastructure projects such as energy generation, water and sewage, roads, and IT facilities.

After all, it is contradictory to allow a surge in U.S. visitors without allowing U.S. business to help to construct the infrastructure required to receive those visitors and to provide them with a secure and comfortable sojourn. The Obama administration allowed U.S. firms to sell to projects that "benefit the Cuban people." It is now time to permit U.S. firms to participate in projects that also benefit the American people, as visitors to Cuba.

The Obama administration authorized Starwood to manage three hotels in Havana owned by Cuban SOEs. This precedent could be followed by a general license authorizing U.S. firms to sign such management contracts, as well as to engage in joint ventures in the tourism sector. This would place U.S. firms on an equal footing with other international hotel chains already operating in the increasingly lucrative Cuban tourism market. We recognize that some expansion revenues would accrue to state-owned enterprises, including the FAR-controlled Gaviota chain, and ultimately the Cuban military, even as most of such revenues go to payments for employee wages of civilians and other non-military vendors (Table 4).

Advancing Sustainability Practices

There are several recommendations in this report where the U.S. government, firms and non-governmental organizations could play a supportive role. The U.S. government should:

- Support local efforts to build a national certification program that sets high standards among the private B&Bs and that ensures tourists of a safe and secure stay.
- Encourage U.S. hotel chains and investors to follow high-quality corporate social responsibility practices in environmental impact, community relations, and labor practices. Valuable in their own right, such high standards can help ensure that the resurgence of U.S. tourism contributes to a warming of U.S.-Cuban relations and avoids some of the tensions of the pre-1959 era.
- Should Cuba establish the proposed international advisory board of architects and city planners, U.S. entities could provide seed financing. U.S. city planning agencies and architectural experts could offer technical assistance as well.
- Foresighted U.S. NGOs are already engaged in promoting sustainability practices in fragile areas in Cuba. We applaud these activities and urge others to join.

* * *

The tourism industry in Cuba, as with the country as whole, holds great promise. It has the potential to help raise national incomes, increase employment in well-paying jobs, and contribute to Cuba's greater participation in the world economy. To realize this promise fully, both Cuban authorities and the U.S. government have to take actions that harness latent market forces to the cause of sustainable economic growth. Neither continued restrictions on trade—whether emanating from the US economic embargo or from excessive government regulation in Cuba—nor laissez faire policies that would likely unleash destructive environmental practices are likely to serve Cuban interests well. Rather the industry's future–like that of Cuba's as a whole–depends on progressive market liberalization in a context of purposeful, modern regulatory institutions.

Annex A. Cuban Hotel Rooms Available 2015

State Sector	
4- to 5-star	44,477
3-star	10,260
1- to 2-star[a]	9,494
Sub-total	64,231
Private B&B	
International (CUC)	15,946
Domestic (CUP)[a]	6,091
Sub-total	22,037
Total	
International	70,683
Domestic	15,585
Total	86,268

[a] Rooms of less than 3 star rarely host international arrivals; similarly, rooms charging in CUP are not typically available to foreigners

Source: José Luis Perelló Cabrera, "Resumen de la renta de alojamiento privado al Cierre de 2015" private communication, 2016.

Annex B: SOE Hotel Groups: Four- and Five-Star Hotels and Rooms

Gaviota				Gran Caribe			
Five-Star	Rooms	Four-Star	Rooms	Five-Star	Rooms	Four-Star	Rooms
Meliá Jardines del Rey	1,176	Memories Varadero	1,025	Tryp Habana Libre	572	Hotel Neptuno Triton	532
Grand Memories Varadero	1,110	Sol Sirenas Coral	651	Hotel Nacional de Cuba	426	Hotel Palma Real	466
Cayo Santa María	854	Naviti Varadero	534			Villa Cuba	365
Iberostar Laguna Azul	814	Pestana Cayo Coco	508			Habana Riviera	352
Ocean Casa del Mar	800	Playa Costa Verde	476			Club Kawama	336
Warwick Cayo Santa María	800	Memories Miramar Habana	427			Hotel Pelicano	307
Memories Azul	720	Memories Caribe	328			Hotel Plaza	188
Meliá Las Dunas	696	H10 Habana Panorama	317			Hotel Jagua	149
Memories Paraiso	666	Sol Cayo Santa María	230			Hotel Inglaterra	83
Memories Flamenco	624	Villa Maguana	16			Encanto La Union	49
Melia Peninsula Varadero	581					Hotel Victoria	31
Memories Holguín	531					Encanto Casa Verde	8
Iberostar Ensenachos	506					Encanto Palacio Azul	7
Iberostar Playa Pilar	482						
Ocean Vista Azul	470						
Melia Marina Varadero	423						
Paradisus Varadero	421						
Ocean Varadero El Patriarca	420						
Iberostar Playa Alameda	391						
Meliá Cayo Santa María	356						
Blau Costa Verde Beach & Resort	309						
Paradisus Río de Oro Resort & SPA	254						
Four Points by Sheraton La Habana	184						
Royalton Cayo Santa María	122						
Meliá Buenavista	105						
Total	13,815		4,512		998		2,873

Source: Web sites of each SOE, SOE printed brochures, cubahotelreservation.com.

Cubanacán				Habaguanex			
Five-Star	Rooms	Four-Star	Rooms	Five-Star	Rooms	Four-Star	Rooms
Melia Varadero	490	Sol Palmeras	608	Hotel Saratoga	96	Hotel Telégrafo	63
Melia Cohiba	462	Tryp Club Cayo Coco	506	Palacio del Marqués de San Felipe	27	Ambos Mundos	52
Colonial Cayo Coco	458	Brisas de Caribe	444	Santa Isabel	27	Palacio O'Farrill	38
Iberostar Parque Central	427	Brisas Guardalavaca	437			Armadores de Santander	32
Royalton Hicacos	400	Brisas Santa Lucía	412			Hotel Florida	25
Melia Habana	397	Breezes Bella Costa	396			Hotel Raquel	25
Iberostar Varadero	386	Blau Varadero	395			Marqués de Prado Ameno	16
Melia Las Americas	340	Iberostar Mojito	352			El Comendador	14
Gran Hotel Iberostar Trinidad	40	Melia Las Antillas	345			Hotel Terra	14
		Comodoro	283			Hotel San Miguel	10
		Breezes Varadero	270			Conde de Villanueva	9
		Memories Jibacoa	250				
		Arenal	249				
		Brisas Trinidad del Mar	241				
		Tuxpan	233				
		Brisas Sierra Mar	200				
		Brisas Covarrubias	180				
		Casa Granda	72				
		Chateau Miramar	50				
		Brisas Los Galeones	34				
Total	3,400		5,957		150		298

Source: Web sites of each SOE, SOE printed brochures, cubahotelreservation.com.

Annex C. Diversifying Tourist Offerings: Medical, Eco-Adventurism, Cruise Ships

Medical Tourism[1]

Cuban Medical Services (Servicios Médicos Cubanos, SMC) offers fee-for-service treatments for foreign patients across the island. Specializations include a "cardiology and cardiovascular surgery program," and various advanced cancer treatments. The New Day "addiction treatment and rehabilitation program" is delivered through five villas equipped with 114 beds and boasts a 45 percent recovery outcome.[2] Over 120 small-scale clinics (Clinicas del Sol), staffed by trained medical personnel and equipped with basic medicines and treatment facilities, are distributed among the larger hotels and tourism poles. International travelers in Havana have access to the Clinica Cira Garcia, a dependency of Cubanacán, where fee-based services are delivered in an attractive, efficient facility for a small fraction of their costs in the United States. MINTUR is working with the Ministry of Communications to develop a tele-medicine long-distance conferencing capacity. Alliances and certifications with established U.S. medical facilities and insurers would give a big boost to Cuba's incipient medical tourism.

Eco-Adventure Tourism

From scuba diving and snorkeling off of colorful coral reefs brimming with luminescent tropical fish to trekking the Sierra Maestra in search of Fidel Castro's rebel headquarters, Cuba offers a full range of outdoor options. The extensive system of protected areas and national parks (see Box 2) are open to tourists through the SOE Ecotur. As a glance at TripAdvisor reveals, visitors typically enjoy their eco-adventure experiences, commenting favorably on the natural beauty and the intelligence and friendliness of the official guides, even as the overall service delivery—transportation, meals, accommodations—is lackluster. As the number of tourists rise, the challenges will be to improve infrastructure and overall service quality and to generate revenues while benefiting local communities and preserving the natural habitats. More resources will have to be invested in improving resource management and oversight. Private tour agencies, including responsible international firms, could be allowed entry, subject to proper standards and audits.

Cruise Ships

Major U.S. cruise lines, including Carnival, Royal Caribbean, and Norwegian, have received U.S. government authorization to visit Cuban ports. Eventually, the big ships will be joined in the Florida Straits by passenger ferries and private boats. Industry sources estimate that cruise ships could bring up to five million travelers to Cuba, once the required port infrastructures are fully in place. But large ships with mass-market day travelers raise the specter of unsightly disruptions to urban ports. Moreover, as the passengers sleep and eat on board, they spend little time or money on-island. Yet Caribbean island nations compete for the cruise ship business because their national treasuries receive docking fees. If properly managed, Cuba can benefit from the influx of cruise ships by directing the ships to dock not only in Havana but at other ports—Cienfuegos, Santiago, Matanzas, Caibarien, Baracoa, eventually Guantanamo—around the island, as it has begun doing, and by enforcing stringent environmental standards. Cuba can generate additional revenues by integrating on-shore visits with local cultural performances, artisanal merchandising, and other "authentic" experiences. The other Caribbean islands fear a loss of business to the Cuban market; in a good-will diplomatic gesture, Cuba could urge the cruise lines to offer multi-destination packages.

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[1] Information in this section draws from the presentation by Jorge Alberto Miranda, president of Servicios Médicos Cubanos (presentation at FITCuba, Havana, Cuba, May 2016).
[2] SMC, "Addiction Treatment and Rehabilitation Program," available at www.smcsalud.cu.

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