



BabunGroup Consulting, Inc.

CUBA CHANGE NEWS ALERT

EXCLUSIVE NEWS OF POTENTIAL INTEREST TO OUR CLIENTS & FRIENDS

September, 2008

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MID-YEAR REVIEW

After half a year as the new president, Raul Castro is facing the challenges of a frustrated society

Our analysis

Urgent measures promised by Raúl Castro continue waiting for the “appropriate moment”. The arsenal of reformations" promoted by Raúl during 2007 have been reduced to a few measures authorizing the entrance to the country of DVDs and other appliances, ownership of cellular phones and free access to foreign hotels in addition to published decrees to reinforce the need for discipline in the labor force and the punishment of corrupt officials. Economic related decrees were limited to: the elimination of salary restriction so that more productive workers are better paid, allowing the operation of private airplanes for foreign companies, allowing farmers access to idle farmlands, access to credits allowing payments in convertible currency to Cuban nationals employed by foreign companies, operation of private taxis, and increasing the number of holidays to include Christmas and New Year.

In several speeches he has deplored, corruption, and inefficiency in the workplace. He told the national assembly: “people are working less. This is a reality that you can confirm in any corner of the nation.” Raul’s tone on July 26 was stern and fairly gloomy, as he warned the populace of harder times ahead, “we must get used to receiving not only good news; we are aware of the great number of problems waiting to be solved, most of which weigh heavily and directly on the population”, he added.

Politically, Raul restructured the government with the old guard by assigning greater power to the old communist party (PCC) members and military leaders – eight generals are now in key leadership positions, he appears to be poised to also restructure the cabinet by the length of this year, and has convened the Congressional Communist Party to meet in July, 2009; the first in the 12 years.

Many experts now believe that a slow transition is the most likely scenario for Cuba between now and the end of the Raul Castro regime, to be followed by cautious steps to move the country forward then under a new socialist regime. Thus, a quick transition to full-blown democracy, wherein most of the Libertad Act requirements are met, is not likely.

In our opinion, there are only two important events pending in Cuba’s politics

- Fidel Castro expires and Raul Castro has full control of the country to take action that today would be considered not to the liking of Fidel. And,
- The presidential elections in the USA. The election of Republican John McCain would be considered a serious defeat for some Cuban Government officials. They are hoping for the U.S. to elect Democrat Barack Obama, with the support of a Democratic majority Congress.

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International Business News on Cuba

- **Cuba's cash not flowing; creditors worry**

Cuba has notified at least two foreign governments that it cannot meet its debt payments and that it wants to renegotiate its indebtedness, the Reuters news agency reported. Western diplomats in Havana did not say what governments were involved but confided that Cuba did not have the funds to fully meet August payments to them or their companies. Canada's Pebercan, which produces oil in Cuba, said in June it had not received debt payments totaling \$37 million from state-owned Cuba Petr6leos (Cupet), which blamed "the difficult economic situation" and rising food and raw material costs for its failure to pay.

- **Japan suspends insurance on exports to Cuba -Nikkei**

Nippon Export and Investment Insurance, the Japanese government-backed provider of trade insurance, has stopped accepting new applications for trade insurance on business with Cuba, the Nikkei business daily reported. The Central Bank of Cuba's failure to pay for Japanese imports by agreed dates is behind the decision, the Nikkei said in a report on its website.

- **Russia Interested in Cuba's Oil**

Russian energy companies OAO Gazprom (OGZPY) and OAO Lukoil Holdings (LUKOY) may revive Soviet-era ties to enter the oil-rich Gulf of Mexico through its Cuban backdoor. Gazprom and Lukoil "are interested in" Cuban hydrocarbons acreage, the country's Basic Industry Minister Yadira Garcia told Dow Jones Newswires at the World Petroleum Congress in Madrid.

- **Brazil's Petrobras near Agreement**

The Brazilian and Cuban state oil companies, Petrobras and CUPET, are on track to sign an oil exploration deal this year. Fidel Rivero, president of CUPET, is quoted by the Estado, a local newspaper, as saying "we are in the concluding phase of a deal. We hope to announce something in coming months." Cuba has around 240 million barrels of proved oil reserves and natural gas in its offshore waters in the Gulf of Mexico, and potential oil resources have been estimated by some as between 4-9 billion barrels.

- **Venezuela to Help Expand Oil Refining Capacity**

Cuba is looking to expand the country's oil refining capacity through a joint venture with Venezuela in the framework of solidarity, integration and cooperation between the two countries. Cuban Basic Industry Minister (Mining and Energy) Yadira Garcia Vera said that the project is being carried out in conjunction with Petroleos de Venezuela (PDVSA) and is expected to be completed in a period of three to four years, reported Juventud Rebelde newspaper. Cuba's state oil company, CUPET, owes Venezuela \$4.6 billion for the 92,000 barrels a day the Caribbean island has received from its ally since 2005, the Caracas daily El Nacional reported. Venezuela's state-oil company PDVSA is waiting to collect the Cuban debt, along with bills yet to be paid by members of the Petrocaribe alliance that total \$7.2 billion, the newspaper said,

- **Chinese Locomotives on Their Way to Cuba**

The first 11 of 40 type DF7G-C diesel-electric locomotives ordered from China Northern February 7th Locomotive Works in Beijing were shipped from the Chinese port of Tianjin on June 12. The rest are due to be dispatched from China during August, along with five DF7K-C Bo-Bo shunting locomotives, reports Britain's *Railway Gazette*.

- **U.S. Wary Of Push To Buy Claims To Confiscated Property In Cuba**

An orchestrated effort may be afoot to persuade companies across the country to sell their decades-old claims, warns the U.S. Foreign Claims Settlement Commission. Mauricio Tamargo, head of the commission, said his agency had begun to receive inquiries last summer from some claimants -- many with sizeable claims -- saying they had been offered payments for those holdings reported the Tampa Tribune.

It is not illegal to sell or purchase these claims, Tamargo said, but the purpose of this sudden activity remains unclear to the government. As a result, the commission has put out an alert for potential sellers and buyers to beware. There are nearly 6,000 American claims registered and certified by the commission for confiscated personal and business property in Cuba, with an estimated total value of \$6 billion.

- **Debt manager sees opportunities in post-Castro Cuba**

City Wire reported that Europe's most consistent emerging bond manager, Sydinvest's Phillip Blackwood, has been buying bonds from Cuba and thinks the country offers 'massive potential'. Blackwood has gone off his benchmark to hold US dollar denominated debt from Cuba in his portfolio. He thinks with a long term view investments in the currently socialist country will pay off.

'Cuba is an area which we are very positive on,' he says. 'It is a patience trade, it's not one that will go crazy in the near term, but we believe it will pay off in the medium term. It has massive potential; with the change in leadership we expect it to soften up and the US to gradually remove sanctions, which will open up fantastic investment opportunities.'

- **Bank ditches UK firms trading with Cuba**

A Somerset health shop selling Cuban sugar and a London tobacconist dealing in Habanos cigars are among British businesses told by a bank to cut their ties with the island or move their accounts. Lloyds TSB has written to customers who have dealings with Cuba saying they will have taken their accounts elsewhere.

- **Cuba's Largest Investor's Profits In "A Free Fall"**

Canadian Sherritt International Corp's profit fell 39 per cent in its last quarter as weaker nickel prices and lower finished metals production more than offset record oil prices. The diversified mining and energy company also warned of higher costs at its Ambatovy nickel project in Madagascar, and said it had abandoned its four offshore oil concessions in Cuba.

Response to Hurricane Gustav

On August 30th, Hurricane Gustav crashed across the Isle of Youth and then the western Cuban mainland as a powerful Category 4 storm with blasts of wind up to 211 miles per hour, leaving widespread destruction and injuries but no reported deaths. The government media called it the worst storm in more than 50 years.

According to the Cuban media, damage to agriculture was massive. More than 32,000 acres of crops were ruined, including 7,239 acres of grain and nearly 1,500 of fruit. Urban farms lost 140 tons of crops. The worst devastation was in the eastern half of the Pinar del Rio province, where 6,000 homes collapsed completely and 11,000 homes in San Cristóbal were damaged. It is also being reported that about 100,000 homes in total were affected.

Organizations such as Catholic Charities (CRS.ORG) and ECHOcuba (ECHOCUBA,ORG) are providing verifiable U.S. private sector support.



A boy and his relatives stand next to debris from their house which has been destroyed by the strong winds of Hurricane Gustav at the city of Nueva Gerona, in Isla de la Juventud, located South of Cuba

Special Reports
Excerpts of Relevant News Reports Since our Last Newsletter

From The Christian Science Monitor

What changes might a new US administration make to its Cuba policy? Sen. John McCain (R) of Arizona supports keeping the tight travel restrictions and limits on remittances that President Bush added to the US trade embargo with Cuba. He said in May that to soften the restrictions "would send the worst possible signal to Cuba's dictators." His stance resonates with the traditionally conservative positions of the Cuban-American community in and around Miami – a key voting bloc in an important swing state that usually votes Republican.

Antonio Jorge, an economics professor from Florida International University who also worked as a finance official in the early years of Fidel's reign, says that Fidel wouldn't allow anything that detracted from absolute central government control. But, he says, that Raúl could, for example, boost the number of categories of small businesses and be more liberal in the granting of licenses, or remove some of the barriers such as high taxes. "These are measures that won't affect his hold on power or change the collectivist nature of the regime, but will improve standards of living for some people," says Jorge. But for now, the burdens Fidel imposed have merely pushed entrepreneurial activity underground.

Cuba now relies heavily on Venezuela, whose leftist President Hugo Chávez sends nearly 100,000 barrels of oil a day to the island in exchange for social services, such as Cuban doctors and teachers. Even though Raúl promises not to veer from the ideals of the revolution, he has publicly acknowledged that the system does not work in its current form. The moves to increase crop production are, in part, a response to a global spike in fuel and food prices, which has made the subsidized food system – once regarded as one of the major successes of the revolution. Many Cubans say the ration does not last them more than three weeks, if that.

In his most recent speech to parliament, Raúl implored his countrymen to work harder and prepare for tough times ahead as the global food crisis ripples toward Cuba. "We have to definitively reverse the decline in the amount of cultivated land," he said, adding that it has shrunk by 33 percent in the past nine years. "Stated simply, we must return to the land. We must make it produce. There is already a clear strategy and a plan of action, from the national level to the lowest level of production."

Currently more than half of arable land lies fallow or is under used, according to Cuban government figures cited by The Associated Press. Cuba spent \$1.5 billion importing food last year. This year it is expected to spend \$1 billion more, say officials.

From El Nuevo Herald

A group of former officials and diplomats of the Cuban Government, who now live in Spain, have posted in the internet a document directed at Raul Castro. The document calls for Castro to "transition the government from a state controlled socialism, to a (citizens) participatory and democratic type of socialism" as the only way for Cuba to deal with possible political, economic, and social crisis.

The document added that there seems to be a build up in the country of “a strange sort of ‘revolutionary situation’ that could explode without warning and which (if allowed to happen) could help the enemies (of Cuba)”

The document lists a series of steps necessary (for Cuba) to exit the current economic and social stagnation, some of which overlap with proposals that have been made by the internal opposition, and which the Castro regime has ignored for decades. Among them are:

- Leave behind the failed centrist and authoritarian system, which is vertically structured from top to bottom, legacy of Stalinism, and instead, move towards a democratic and decentralized system.
- Admit other forms of property and production.
- Establish quickly one currency to achieve a true integration of the national economy.
- Recognize that the problem of the agriculture not only resides in distributing the idle lands, but also in freeing the agricultural production of those “state padlocks” which have been placed over planting, storing, prices, transport and the market.
- Seek more participatory, democratic and direct formulas in the electoral processes.
- Upgrade the Penal Code which has been in effect since 1987, and revise the excessive jail terms being issued for political problems.
- Respect private personal property, and allow the sales of cars and houses, as well as the right to free rent, between national citizens.
- Create a new immigration law, and eliminate the need to obtain an exit permit and a letter of invitation, with sufficient guarantees that the citizens will be able to freely return back to the country.
- Lift the blockade (from being able to move to the City of Havana) of young blacks, people from the interior, and of other Cubans. And suspend the polemic Ordinance 217 of 1997, which limits the free movement of Cubans throughout the national territory.

From Lee Sustar

Sam Farber, a long time socialist and author of numerous books on Cuba says that as long as Fidel has the ability to function to that extent, Raúl won't go too far. It's a status quo succession, to a large extent.

On the other hand, there may be some measures of liberalization that Raúl is able to implement. Perhaps the biggest single issue now is agriculture. With the collapse of the sugar industry, there are huge areas of farmland that aren't being used for anything.

So the question has come up: Should it be turned over to private farmers, as in the former Stalinist states of Eastern Europe? There, as well as in Cuba, private farms have been shown to be more productive and efficient. Raúl has hinted that he may do something in that direction. That would be a very big step, and I don't know how Fidel would look at that.

Perhaps more relevant is that there was significant improvements in the delivery of electricity. Blackouts, frequent in the past, have almost disappeared. And with the import of buses from China, urban transportation, which is a humongous problem in Cuba, has improved--and that in turn would have an impact on the productivity of the labor force, as people are better able to get to work on time.

But a bifurcated economy continues to exist. Forty percent of Cubans have no access to dollars, and for the other 60 percent, access can vary a great deal. Some of those who have access get

dollars sent by relatives from abroad, and the others mainly through the joint ventures and the tourist industry in Cuba.

Raúl has hinted at a revaluation of the Cuban currency so that people will get more dollars for their pesos. And he has already made it very clear, in his important speech on July 26, 2007, that the salaries of people are inadequate to make a living.

A substantial upward revaluation of the peso in the absence of a dramatic increase in the production of goods would leave very little to buy in a very short period of time. Right now, the dual currency acts as a very inequitable but effective form of rationing.

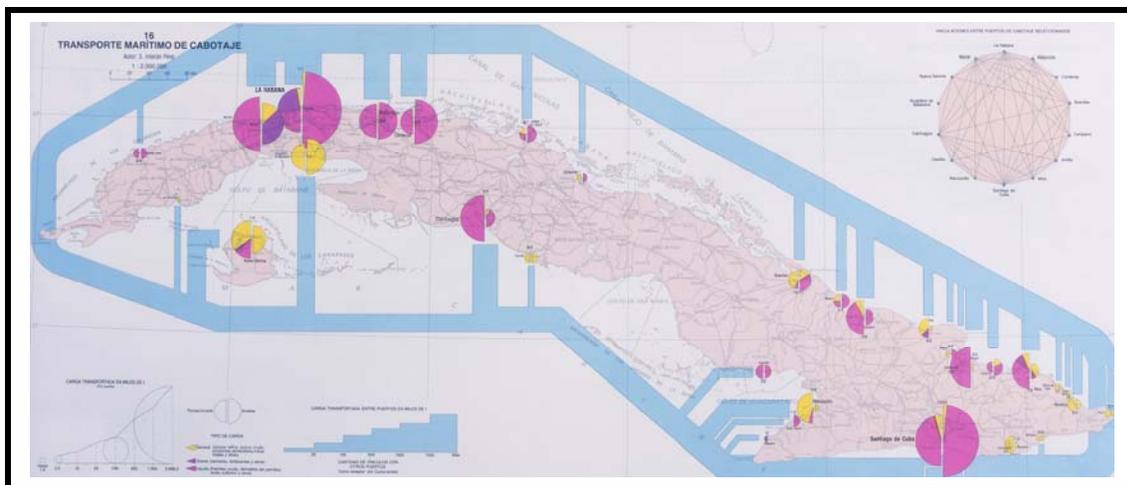
In relative terms, the army is the most efficient and best-organized institution in Cuba. Its people are being promoted now, and they're cementing that power. For example, as head of state, Raúl Castro promoted another old-timer, Major Gen. Julio Casas Regueiro, as minister of defense. Casas oversaw the "*perfeccionamiento empresarial*"--an efficiency drive in companies run by the military.

So the army is a major force. He is trying to have as much state control as possible without the state committing suicide. Another example is that they cut down on foreign investment in Cuba by restricting the number of joint ventures.

Raul represents the introduction of elements of the Chinese and Vietnamese economic model--a turn to the free market while retaining state control. In April 2005, he went to Shanghai and said, "Here, I found that another world is possible." This is obscene--taking over the slogan of the World Social Forum to express his admiration for the Chinese model.

Obviously, there are huge differences between Cuba and China, and the United States is an obstacle. But if Barack Obama is elected president, and he follows through on what he is hinting at--resumption of relations with Cuba--all sorts of things are conceivable. Of course, Democratic Party politicians are masters at promising things that they have no intention of carrying out.

Politically, the U.S. is unlikely to collaborate with a Vietnamese or Chinese type transition in Cuba as long as someone named Castro is heading the Cuban state. But it's possible, for example, to remove limits on Cuban-Americans' travel to Cuba.



BGC News and Consulting Activities



- Babun Group unveiled its new web page at www.cubadata.com
- The Association for the Study of the Cuban Economy, ASCE held its 18th Annual Meeting on August 5-7 at the Miami Hilton Downtown. Dr. Teo A. Babun, President and CEO of BabunGroup Consulting chaired the session titled “Infrastructure: Power and Waste/Water Sectors”. The session represented the collaborated effort of ASCE, the U.S. Government and various associations of professional engineers interested in studying and preparing white papers to deal with the efforts needed in Cuba following a transition.

The panel of experts included:

- Manuel Cereijo, University of Miami, “Cuban Power Sector: Present Situation”
 - Juan A.B. Belt, USAID, “Energy Sector in Cuba: Financial and Economic Considerations”
 - Armando Pérez. Cuban-American Association of Civil Engineers (C-AACE) and Helena Solo-Gabriele, Association of Cuban Engineers (ACE), “Water and Sanitation Issues in Cuba: A Status Report on Research”
 - Discussants: Jorge Piñón, University of Miami; María Porrata, Marlin Engineering
- During the summer months Dr. Babun also participated in multiple radio and television interviews related to Cuba’s industry and investment potential following renewed relations with the United States.

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Exporting to Cuba

U.S. Trade with Cuba, 2000-2007

Year	Total Exports (Value in millions of U.S. dollars)
2007	\$447.1
2006	\$340.5
2005	\$369.0
2004	\$404.1
2003	\$259.1
2002	\$145.9
2001	\$7.2
2000	\$7.0

Source: U.S. Census Bureau, Foreign Trade Statistics, "Trade in Goods with Cuba," <http://www.census.gov/foreign-trade/balance/c2390.html> (accessed July 2008).

Select U.S. Exports to Cuba, 2007

Goods	Value (in millions of U.S. dollars)
Corn	\$109.019
Meats (including poultry)	\$84.825
Wheat	\$70.175
Animal Feed	\$56.813
Soybeans	\$43.773
Rice	\$24.676
Oilseeds/Food Oils	\$20.451
Wood (logs and lumber)	\$8.956
Vegetables	\$2.260
Fruits (including frozen juices)	\$1.926
Pharmaceutical preparations	\$1.866

Source: Adapted from U.S. Census Bureau, Foreign Trade Statistics, "U.S. Exports to Cuba from 2003 to 2007 By 5-digit End-use Code," <http://www.census.gov/foreign-trade/statistics/product/enduse/exports/c2390.html> (accessed July 2008).

Top States: Exports to Cuba, 2007

State (ranked in order of exports)	Total Exports (value in millions of U.S. dollars)
Louisiana	\$173.270
Texas	\$57.795
Florida	\$42.015
Virginia	\$32.630
Minnesota	\$21.141
Kansas	\$19.826
Nebraska	\$18.881
Georgia	\$15.389
Illinois	\$5.643
North Carolina	\$3.281
Alabama	\$3.019
Arkansas	\$1.377

Source: U.S. Department of Commerce, International Trade Administration, State Export Data, <http://tse.export.gov> (accessed July 2008).

Cuba's Top Five Trading Partners (Imports), 2006

Country (ranked in order of imports by Cuba)	Exports to Cuba (in billions of U.S. dollars)
Venezuela	\$2.209
China	\$1.569
Spain	\$0.846
Germany	\$0.616
United States	\$0.484

Source: Cuba, Oficina Nacional de Estadísticas (ONE), *Anuario Estadístico de Cuba 2006* (2007).

Cuba Geopolitical Outlook

- **Access to professional Staff:** BGC is known as a business-driven watch group that informs/updates/advises multinationals throughout the world to understand the goings on in Cuba. Our company has substantial expertise in Cuba issues; we often provide independent feasibility analysis and other business consulting and research assignments to multinational corporations. Our company has under contract to two former ministers and over 40 experts on different industries/expertise related to Cuba. **-Contact us for a full brochure.**
- **Customized executive briefings:** BGC conducts informal discussions/briefings on Cuba issues with client's staff. The briefing sessions are general and informal business focused (not academic) presentations and discussions regarding current Cuba and US-Cuba subjects. The number and timing of the sessions is at the discretion of the client. **-Contact us for rates.**
- **Business reports:** BGC is experienced in preparing reports to help provide a preliminary strategic plan and overview of issues related to a possible economic opening of Cuba to allow the client to conduct business operations in the emerging (future) new market. This "Analysis for Strategic Direction" could be drafted as a "Quick-Response Business Plan" in the event that things suddenly change in Cuba and it becomes permissible to do business in the Island. Our first step is to conduct a confidential meeting to help develop a scope of work at no cost to the potential client; following the scope of work we would determine the cost of such assignment. **-Contact us for an appointment.**

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BabunGroup Consulting, Inc. is regarded as one of America's largest providers of strategic services related to Cuba. Since 1991, BGC has been engaged by a number of companies who are planning to expand or who for competitive or strategic reasons need to know more about future opportunities in a post-transition Cuba.