

# Macroeconomics & Fiscal Management

## MFM PRACTICE NOTES

### THE IMPACT OF EASING THE US TRAVEL RESTRICTIONS AGAINST CUBA ON TOURISM IN THE OECS

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**The US authorities announced in December 2014 an intention to normalize relations with Cuba, including measures to ease economic sanctions and the ban on US citizens' travel to Cuba.** Although the embargo is still in place and leisure travel from the United States to Cuba is still not allowed, the new measures permit Americans to visit the island for a variety of reasons, including family visits, education, and religion, without first obtaining a special license from the US government, as was previously required. The normalization of US relations with Cuba is expected to have important effects on tourism flows from the United States to the island. Cuban officials estimate that 1.5 million Americans would travel to the island annually if all restrictions were removed; an IMF study in 2008 projected that 3.0-3.5 million US tourists would enter Cuba if the travel restrictions were removed (Romeu 2008).

**The impact of the easing of US travel restrictions against Cuba on the tourism sector of the OECS countries is potentially positive.** The analysis was conducted in two steps. The Bank team first estimated the level of restrictiveness caused by the US travel restrictions on Cuban tourism performances;

second, the team simulated, through a global computable general equilibrium (CGE) model, the impact of the removal of restrictions on Cuban tourism. The results show that all the Organization of Eastern Caribbean States (OECS) countries would experience a reduction in arrivals from the United States, while the overall effect of the removal of the travel restrictions would not be negative. In fact, those that have many non-US tourists, will see a surge in these, as they are driven away from Cuba by the rising cost of tourism to Cuba by the rising tide of new American arrivals to that destination. The OECS, considered as a whole, would enjoy a modest increase in tourist arrivals following the removal of the US restrictions. Except for St. Kitts and Nevis and Anguilla, the overall effect is either negligible or significantly positive for the OECS countries that depend more on Canadian and other Caribbean countries for their tourism.

#### **Will the Easing of Restrictions on Travel to Cuba Matter to the OECS?**

**The tourism sector is a major source of growth, employment, government revenue, and foreign exchange for the OECS countries.** Of the OECS countries with sufficient data available, tourism accounts for one to three quarters of total GDP, and from over 20 percent to just under 70 percent of employment. Tourism also generates more

<sup>1</sup> This Knowledge Note was cleared by Miria Pigato, Practice Manager (GMFDR).

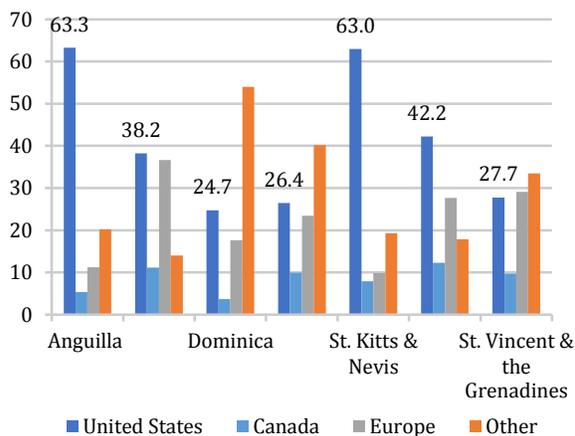
than 50 percent of total export receipts in five of the seven countries. Anguilla, and Antigua and Barbuda are the most dependent on earnings from tourism, which generates 84 percent and 74 percent of export receipts, respectively.

**The easing of restriction on US citizens' travel to Cuba by US citizens is likely to reduce their arrivals in the Caribbean in general, and the OECS in particular.** OECS countries are greatly dependent on tourists from the US and provide a tourism product relatively similar to that of Cuba (Figure 1). In 2014, the United States was the largest source of tourist arrivals for most OECS countries; the share of arrivals from the United States varied between 25 percent of the total for Dominica and more than 60 percent for Anguilla and St. Kitts and Nevis. St. Lucia, which receives the largest number of tourists among the OECS members (around 35 percent of OECS total arrivals), received 42 percent of its tourists from the US in 2014. In addition to losing tourists from the United States, the OECS and other Caribbean countries may also lose tourists from other developed countries such as Canada, the United Kingdom, and Germany, as the cost of travel to Cuba decreases with the easing of the US travel restrictions.

**The rise in US visitors to Cuba, however, could also have positive effects on tourism in the OECS countries.** A sharp rise in tourists from the United States could strain Cuba's limited tourism infrastructure and redirect tourists from other developed countries to the OECS and other Caribbean countries (IMF 2008). Furthermore, the prestige of the Cuban destination is likely to strengthen the position of the Caribbean destinations as a whole, which could be

beneficial for countries in the region that can promote multiple destination travel packages that include Cuba.

**Figure 1. Tourism to the OECS, by country of origin**  
(Percent of total arrivals)



Source: World Bank staff calculations based on data from the Caribbean Tourism Organization.<sup>2</sup>

### To what Extent does the US Embargo Currently Limit Tourism in Cuba?

**A gravity model can be used to measure the impact of the US travel restrictions on tourism.** The gravity model predicts the level of tourism flows between economies based on size, income level, distance, degree of contiguity of borders, a common language, and whether one was a colony of the other or were colonies of the same country (see Romeu 2008 and Laframboise et al. 2014).<sup>3</sup> The analysis covers bilateral tourism receipts (or arrivals) among 194 countries during 2000-10, using data from the United Nations World Tourism Organization.<sup>4</sup> The level of

<sup>2</sup>

<http://www.onecaribbean.org/content/files/TAcbbnMainmarket1980to2004.pdf>

<sup>3</sup> Beside these standard indicators, the team also integrated some specific determinants of tourism, including external shocks (September 11 2011); security (number of homicides); existing trade and investment agreements (NAFTA, CARICOM, US Caribbean Basin initiative), trade openness, and infrastructure (telecommunication penetration).

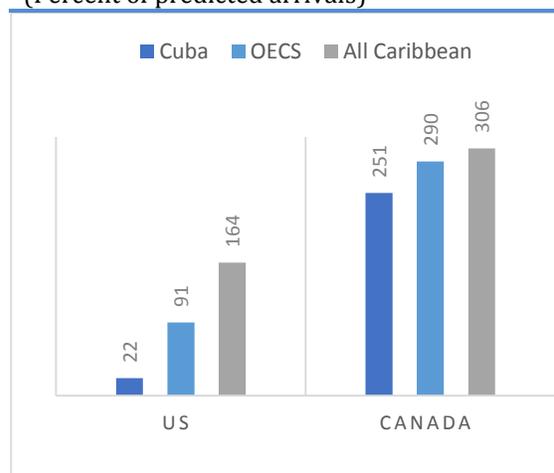
<sup>4</sup> Although the team followed previous studies using a gravity model, our approach includes several improvements that generate an estimate that is more rigorous and better grounded in modern trade theory. First, we control for zero trade flows with the Heckman sample selection correction method. Second, a measure of remoteness is computed by summing distances weighted by the share of the GDP of the destination in world GDP. This variable captures the effect of relative distance on trade, which matters greatly, in addition to the absolute

restriction caused by the US travel restrictions on Cuba is captured by comparing the gap between actual tourist arrivals from the United States and the performance predicted by the gravity model.

**The travel restrictions significantly reduce US tourism flows to Cuba** (Figure 2). The results show that Cuba provides far less tourism services to the United States than expected, given each country's economic size, bilateral distance, and the other determinants. In fact, the number of arrivals of US tourists in Cuba represents just 22 percent of the expected level. By contrast, the number of arrivals of US tourists in the Caribbean is around 164 percent of the level predicted by the gravity model. Although the OECS also seems to be exporting less tourism services than expected to the United States, the performance gap (10 percent below the predicted level) is far lower than that of Cuba. An analysis of Canadian tourism in Caribbean countries also provides some insight into the impact of the US travel restrictions on tourism in Cuba. Contrary to the analysis of US tourism, the number of Canadian tourist arrivals in Cuba is about 251 percent of the predicted level. And Canadian tourist arrivals in the OECS and other Caribbean countries are 290 percent and 300 percent, respectively, of the predicted level. These findings provide further evidence that the gap in

US tourism to Cuba (78 percent) can be attributed to the US travel restrictions.

**Figure 2. US and Canadian tourist arrivals, 2010**  
(Percent of predicted arrivals)



Source: World Bank staff calculations using Gravity Model Estimates.

Note: This figure shows the observed bilateral tourism arrivals in 2010 as a ratio of their expected value predicted by the gravity model. Bars under (above) 100 indicate that the observed value is smaller (larger) than what is predicted by the econometric model.

**Table 1. Impact of Easing Ban on US travel to Cuba on Caribbean Countries (CGE results)**

Countries	Baseline		Effects	
	Initial Total Arrivals (2014)	US share in total Arrivals (in %)	Change in US Arrivals (% US Arrivals)	Change in Total arrivals (% total arrivals)
Anguilla	62,353	63	-18.2	-3.6
Antigua and Barbuda	249,316	38	-13.4	1.21
Dominica	68,791	25	-8.35	8.7
OECS Countries				
Grenada	133,520	26	-9.3	6.8
St. Kitts and Nevis	74,317	63	-11	-2.2
St. Lucia	338,158	42	-9.9	-0.4
St. Vincent and the Grenadines	61,684	28	-12.5	-0.4
Cuba	3,000,000	20	350	54.2
Totals				
All OECS	988,139	40	-11.7	1.35

Source: Authors' Calculation using CGE estimates.

## What would be the Likely Impact on the OECS Countries of a Full Removal of the US restrictions on Cuban Tourism?

The easing of the US sanctions would have important economic implications for the OECS tourism (Table 1). Allowing Cuba to export tourism services to the US without the restrictions of the US embargo (the level predicted by gravity model) would lead to an around 350 percent increase in American arrivals, from around 600,000 (in 2014) to 2.7 million per year, with important implications for OECS tourism sectors.<sup>5</sup> All of the OECS members would experience a reduction in arrivals from the US, the effects ranging from (-18) percent for Anguilla, to (-8) percent for Dominica. However, the overall effect of the removal of the travel restrictions (taking into account other sources of tourism) would not be negative for all OECS countries. Those that have many non-US tourists, will see a surge of these as they are driven away from Cuba by rising costs caused by the tide of newly arriving Americans to that country. The

estimates show that the unskilled labor wage and CPI would increase by 22 percent, and 14 percent respectively in Cuba, while remaining relatively unchanged in most OECS and Caribbean countries. As a result, the OECS as a whole would enjoy an increase in tourist arrivals by 1.35 percent following the removal of the US restrictions. While the overall effect is negative for St. Kitts and Nevis, and Anguilla that rely on the United States for 63 percent of their tourism, it is either negligible or significantly positive for the other OECS countries that depend more on Canadian and other Caribbean countries for their tourism.

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<sup>5</sup> The impact of the US travel restrictions is measured by a global computable general equilibrium (CGE) model. The analysis relies on a multi-country static model using the Global

Trade Analysis project (GTAP) framework (Hertel 1997) and social accounting matrices of 2011, including separately most Caribbean countries, the US, and the rest of the world.