

## **CHAPTER 4**

# **Establishing the Core Institutions of a Free Economy**



## **I. EXECUTIVE SUMMARY**

The Cuban economic system is broken; it will not be easily fixed. It will take time to build national institutions, as well as develop in individuals the attitudes, expertise, and skills capable of managing Cuba's reconstruction. Lessons learned from other transition countries demonstrate that it is extremely important to identify and prioritize needs, and to manage expectations correctly.

The reconstruction effort in a free Cuba will also be costly. In this regard, the burden of reconstruction need not fall completely on the shoulders of the United States and must be done in close consultation with the Cuban people. There is a significant role to be played by the international donor community, the international financial institutions (IFIs) including the Inter-American Development Bank (IDB), and the United Nation's development agencies, all of which can provide programs and assistance to a free Cuba. We should seek engagement by the international community and the IFIs to better ensure a smooth transition when the time comes.

Economic change in Cuba will not occur in a vacuum. Two generations have grown up under Castro's repressive system. There are Cubans (e.g., the communist elite) who will have vested interests in maintaining the status quo. They will present a difficult but not unprecedented problem, one that experience shows will not be easily solved. As we have learned elsewhere, a disenfranchised political elite and military can be dangerous.

It is crucial that the Cuban people are full partners in the reform process, that whatever proposals we make to a free Cuban people are realistic, and that any promises made are promises kept.

## **IMMEDIATE ACTIONS**

Stabilizing and liberalizing the economy are fundamental preconditions for economic growth and for the creation of a viable free market economy. A free Cuba should design a macroeconomic stabilization and growth program to ensure price stability and to anchor the expectations of its population. A stable macroeconomic environment is a necessary precondition to support high levels of investment and productivity growth. The core components of a stabilization policy include sound fiscal and monetary policies that limit deficits to sustainable levels

and limit the monetary financing of these deficits. Closely linked to the monetary policy is a decision over the exchange rate regime, which will be the decision of the new Cuban transition government.

The United States, the international community, and the IFIs (including the IDB) can offer assistance and resources to a free Cuba to design an effective economic strategy that includes sound macroeconomic policies, price liberalization, deregulation, investment climate and legal reforms, and privatization. We should draw on experiences in working with other non-market economy transitions to encourage Cuba to decontrol prices in the near term.

The U.S. Government should work with the IFIs, NGOs, and other interested parties to make the preparations to assist a free Cuba to gain access to short term financing for trade and reauthorizing the trade credit insurance program for Cuba. The U.S. Government should work with a free Cuba so that it can qualify for, at the earliest appropriate time, preferential benefits under the Caribbean Basin Economic Recovery Act (CBERA) and the U.S. Generalized System of Preferences (GSP). The U.S. Government should also establish a Joint Committee on Trade and Investment (JCTI) which could serve as a first step toward possible negotiation of a Free Trade Agreement with a free Cuba, and should be prepared to move quickly to establish an embassy in Havana with strong commercial and agricultural components, in order to provide information to and establish contacts for U.S. companies interested in exporting to or investing in Cuba. Moreover, the U.S. Government should be prepared to encourage its regional allies to include a free Cuba in regional free trade arrangements and work with Cuba in the World Trade Organization to further reduce barriers.

A free Cuba will urgently need to engage the IFIs, including the Inter-American Development Bank. We should encourage the IFIs to engage fully with a free Cuba, including technical assistance and financing as soon as possible. Finally, the U.S. Government should be prepared to work through existing international institutions and with a free Cuba's other bilateral partners to address financing needs, including debt relief from its creditors and donor aid.

If requested by a transition Cuban government, the U.S. Government, in coordination with the IFIs, should be prepared to assist in developing a new investment regime that fosters foreign investment and eliminates restrictions to

trade and investment. The U.S. Government should also consider negotiating a Bilateral Investment Treaty at the earliest possible time in the transition.

The U.S. Government, in order to prepare for a transition and to be ready to implement programs quickly, should consider establishing a Standing Committee for Economic Reconstruction (SCER) to review specifically and regularly reconstruction plans and to ensure that appropriate U.S. Government agencies are prepared to implement programs immediately. Strong consideration also should be given to establishing a standing private sector advisory committee. As an initial step, this standing committee could review and comment upon this report, ensuring that it becomes a longer term planning document. The committee could then meet on a regular basis to complement the SCER in planning for prompt assistance to a free Cuba.

## **MEDIUM- AND LONG-TERM ACTIONS**

Settling the issue of expropriated properties will be critical to a transition Cuban Government. Proper resolution of this issue will be seen by many as a signal that Cuba is once again open for normal business. Potential investors will be reluctant to get involved in Cuba as long as questions of ownership, property rights, and restitution remain unsettled. The longer this issue remains open, the longer it will take for Cuba's financial and economic recovery. This will be especially true in cases of the ownership and clear title of commercial property. As progress is made in this area, so will progress be made in getting businesses established, jobs created, and the economy growing.

The U.S. Government should encourage a free Cuba to indicate at an early stage in the transition, and in the strongest possible terms, that it intends to settle the expropriation issue as quickly as it can and in an open and fair manner. The U.S. Government should also encourage Cuba to settle outstanding claims issues as expeditiously as possible, using an open, transparent process.

The U.S. Government should work with the Cuban-American community and a free Cuba to facilitate the low-cost, speedy transfer of remittances and promote their use to finance self-employment and small business start-ups in Cuba. The U.S. Government should encourage the Cuban-American community and the larger U.S. investment community to create a "Friends of Cuba" organization that could provide private-sector support to Cuba during transition and assist in

promoting microfinancing and a more open flow of goods and services on the island.

The U.S. Government should be prepared to offer assistance to a transition government in developing an independent central bank and, along with the IFIs, offer to provide technical assistance to develop its banking system, including its regulatory framework.

The U.S. Government, in conjunction with the IFIs, also should offer to provide technical assistance on budgeting, expenditure management, debt management, and procurement rules, as well as technical assistance to help set up a new revenue collection agency and to ensure its enforcement capabilities.

The U.S. Government should offer to assist in developing a more rational design for Cuba's numerous economic ministries and encourage the World Bank to assist with reforming the public sector through its Governance Reform Program. The U.S. Government, working with other Latin American allies, should be prepared to provide assistance to Cuba in the area of e-government.

The U.S. Government, if requested, should offer a free Cuba assistance in re-creating the right to own, rent, and sell private property, with particular emphasis on homeownership. The U.S. Government, based on its experience, should offer to provide advice in establishing a credit-enhancing agency along the lines the Federal Housing Administration (FHA) initially followed and assist Cuba in developing primary and secondary mortgage markets. It should also assist in the implementation of a framework for the protection of intellectual property, encouraging investment and jobs.

The U.S. Government should offer to help establish mechanisms to place workers in new jobs. Technical advice should be offered to help change the laws and role of the Labor Ministry to allow a free labor market to function. Changing attitudes about the government's role in providing employment will be essential to a free Cuba's economic prosperity.

The U.S. Government should offer technical advice to a transition government in supporting projects that create healthy labor-management relations and assist Cuba by providing a coordinated process to revise labor laws to be

consistent with International Labor Organization (ILO) standards and promote strengthened labor-management relations.

The U.S. Government should be prepared to provide training to Cuban entrepreneurs, focusing on harvesting the benefits of a market economy. The U.S. Government should encourage a free Cuba to permit employees of denationalized firms and agricultural cooperatives to purchase shares in these formerly state-owned enterprises. The U.S. Government should extend its trade capacity building efforts to Cuba, including those geared toward rural development and export diversification, and work with a Cuban transition government to remove all obstacles to self-employment and other forms of entrepreneurship in a free Cuba. The U.S. Government should greatly expand programs that assist in training mid-level managers in U.S. business practices.

## **II. INTRODUCTION**

Political change in Cuba will be accompanied by change in the economic framework of the country. Lessons learned in the transition of the centrally planned economic systems of Eastern Europe and the former Soviet Union teach us that this can be an arduous process where it is extremely important to manage expectations correctly. Critics claim that proponents of free markets and economic liberalization have oversold the benefits to countries that adopt them and to their citizens. Promised results have not kept pace with popular expectations and, as a result, dissatisfaction has spawned a counter reaction, and led to the rise of governments that are not ideologically committed to democratic and free market values (e.g., the Chavez government in Venezuela). Replacing Cuba's state-controlled economic model with a free market system will create hopes that economic growth and job creation will occur in a fairly short period of time. The expected inflow of U.S. business people, talking of investment and trade, will reinforce those hopes.

Past experiences show that growth may be slow and uneven in coming. Cuba's infrastructure, both institutional and physical, is either nonexistent or inadequate. Creating institutions to support the new economy, creating a new legal structure, including new economic and commercial legislation and regulations, and refurbishing/replacing an existing physical infrastructure is time consuming and, in the latter instance, expensive.

Historically, even in countries where reasonable physical and bureaucratic infrastructures were in place, the transition to a free market model was slow, painful, and politically sensitive. The former Soviet Union and Eastern Europe demonstrate the enormous challenges facing transition governments. Where the necessary political will and economic infrastructure were lacking, efforts to promote democracy and free markets have failed.

Economic change in Cuba will not occur in a vacuum. Besides the lack of necessary infrastructure, there are numerous other important factors to consider. Among these is the fact that, for more than four decades, the people of Cuba have been subject to a repressive regime that rarely rewarded private initiative. Two generations of Cubans have grown up under this centralized economic system. And there are Cubans (e.g., the communist elite) who will have vested interests in maintaining the economic status quo; they will present a unique problem.

It is therefore crucial that the Cuban people are the centerpiece of any reform process, that whatever proposals made to the Cuban people are realistic, and that any promises made are promises kept. There are a number of activities and programs that need to be put in place immediately during a transition. It is essential that actions to establish the social safety net be prioritized and implemented to mitigate changes that may cause hardship to the Cuban people.

There are a number of issues affecting the establishment of a free economy, among them:

#### **A. Centralized Economic Control**

The Cuban state owns, operates, and regulates virtually all means of production, employment, and pricing in Cuba today. State-owned and operated enterprises and joint ventures with foreign partners are virtually the only sources of lawful employment. The state screens candidates for jobs in joint-venture firms; Cuban workers receive only 5 percent of the salary paid by foreign investors to the Cuban state. The military controls a lion's share of Cuba's present economy, including control over several key ministries.

Since 1993, when the Cuban economic crisis hit bottom as a result of the withdrawal of subsidies from the Soviet Union, Cuba has somewhat stabilized its economic freefall. In part, it has done this by aggressively pursuing joint ventures

with foreign investors and exploiting humanitarian policies designed to alleviate the suffering of the Cuban people (see Chapter 1). However, gross domestic product (GDP) in 2003 was still below 1989 levels.

Cuba's precarious economic position is complicated by the high cost of foreign financing. Castro's government defaulted on most of its international debt in 1986 and does not have access to credit from international financial institutions like the World Bank. As a result, Havana must rely heavily on short-term loans to finance imports, chiefly food and fuel. Because of its poor credit rating, a \$12.2 billion hard currency debt, and the risks associated with lending to Cuba, interest rates have reportedly been as high as 22 percent. In 2002, citing chronic delinquencies and mounting short-term debts, Moody's lowered Cuba's credit rating to Caa1 — "speculative grade, very poor." Furthermore, Dunn and Bradstreet rate Cuba as one of the riskiest economies in the world.<sup>1</sup>

Limited economic reforms in the early-to-mid 1990s were introduced out of necessity by the Castro regime to encourage more efficient enterprises and to permit limited self-employment. But beginning in 1995, state enterprises, as well as the self-employed, were subjected to increased control and curtailment of economic activities. This trend towards re-centralization of economic activity continues today. No independent labor unions exist, collective bargaining is not allowed, and strikes are outlawed. Cuban state salaries, which are paid in Cuban pesos, are insufficient to meet the minimum basic needs of the population given the "dollarized" dual economy. Prices are regulated by the state with no regard to market conditions.

The *Wall Street Journal*/Heritage Foundation's *Index of Economic Freedom 2004* ranks Cuba among the world's most economically repressed societies, putting it in the same category as North Korea, Iran, and Libya.

## **B. Outstanding Expropriated Property Claims**

The expropriation of U.S. assets was one of the major initial causes of the deterioration of relations between Castro's Cuba and the United States and of the imposition of the U.S. trade embargo. The U.S. Foreign Claims Settlement

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<sup>1</sup> "Debt Default Hurts Cuba's Credit Rating," *The Miami Herald* (April 8, 2002), p. 19G, as cited on cubanet.org.

Commission (FCSC) has certified 5,911 claims (totaling about \$1.8 billion) by U.S. nationals against the Castro regime for the taking of their property since January 1, 1959. Of this amount, more than 85 percent, or \$1.58 billion, involves 898 corporate claimants and the rest corresponds to individual claimants. One hundred thirty-one (131) of the 5,911 claimants — 92 corporations and 39 individuals — have certified claims of \$1 million or more. Forty-three corporate claimants and five individuals have certified claims in excess of \$5 million. The FCSC determined that simple interest at 6 percent should be included as part of the certified claims. Using this figure results in a value in excess of \$7 billion, as of April 2004.

Expropriation claims by nationals of other countries were much smaller than those of the United States. For the most part, they have been settled through bilateral agreements between Cuba and the respective country, although often at a fraction of the assessed value and at a very slow payout rate by the Castro regime. For example, Spanish claims were valued at \$350 million, but settled for \$40 million. Even with the sizeable reduction, Cuba took six years to pay the agreed value. In addition, Cuba also expropriated property from a large part of the Cuban population, including some who have become U.S. citizens. This, too, will be a key issue that Cuba must grapple with when settling outstanding property claims.

### **C. Lack of Private Property Rights, Including Real and Intellectual Property Rights**

Cuban citizens cannot legally buy or sell real property (unless specifically authorized by permit — e.g., purchasing an automobile). They may trade homes or apartments, provided, however, that no money changes hands. Typically, housing swaps involve under-the-table money exchanges, with Cubans who are caught suffering severe penalties. The fact that Cubans may trade, but may not buy or sell dwellings, creates a special difficulty for families that change size or for Cubans who move from one place to another.

Prolonged austerity and the state controlled economy's inefficiency in providing adequate goods and services have created conditions for an active informal, black market economy. As the variety and amount of goods available in state-run peso stores has declined, Cubans have turned increasingly to the black market to obtain needed food, clothing, and household items. Pilfering of items from the workplace to sell on the black market or illegally offering services on the

sidelines of official employment is common. Cuban companies regularly figure 15 percent in losses into their production plans to cover this illegal activity. A report by an independent economist and opposition leader speculates that 40 percent of the Cuban economy operates in the informal sector.

Article 15 of Cuba's communist constitution broadly defines "socialist state patrimony" to include all lands not owned by small agricultural producers or cooperatives formed by small agricultural producers. This "patrimony" includes properties expropriated from foreign nationals as well as properties left by Cubans forced to flee the island. The constitution also specifically prohibits mortgages on small landholdings. All major real estate transactions are negotiated through a central market, although a black market among Cubans exists parallel to the official central market. Article 23, however, allows foreign investors to acquire and hold rights, pursuant to Article 15, to assets forming part of the "socialist state patrimony," but only upon prior and specific approval of the Council of Ministers or its executive committee.

Cuban citizens cannot enter into contractual obligations with one another or with foreigners. Only the Cuban state, or a Cuban state entity, can legally contract with third-country nationals. For example, contracts for the purchase of U.S. agricultural products, sales of which are permitted by U.S. law, are negotiated with the Cuban Ministry of Foreign Trade's *Empresa Comercializadora de Alimentos* (Alimport), not with private Cubans or foreign investors in Cuba.

In terms of intellectual property, although Cuba theoretically issues patents to individual inventors, the patent holder has a binding "social obligation" to license/transfer the patent to the state in order to "benefit" society.

#### **D. Constraints Upon Entrepreneurship**

The state is the largest employer in Cuba. According to Cuban government statistics, about 75 percent of the labor force is employed by the state. The actual figure may be more than 90 percent, with some 150,000 small farmers and another 108,000 "*cuentapropistas*," or holders of licenses for self-employment, out of a total workforce of about 4.4 million people.

Today the state rarely grants new licenses for lawful self-employment. Moreover, existing self-employed workers are subjected to constant harassment

and Cuba has revoked many existing licenses or failed to renew them. In the agricultural sector, so-called “violators” may be subjected to detention, heavy fines of up to 1,500 Cuban pesos, and/or the confiscation of their goods. Only the self-employed pay personal income taxes. The *Oficina Nacional de Atencion Tributaria* (ONAT), Cuba’s internal revenue agency, is in charge of repressing/curtailing lawful self-employment and does so through onerous tax practices.

Finally, the self-employed are specifically prohibited from forming “cooperatives, associations or any type of collective production organization.” As a result of stricter controls and harassment, the overall self-employed sector has declined from 208,500 in 1995 to about 100,000 in 2003.<sup>2</sup>

### **III. IMMEDIATE ACTIONS**

#### **A. Introduction**

Based on an analysis of transitions from non-market to market economies in Eastern Europe and the former Soviet Union, the World Bank drew some lessons and recommendations from the most successful reform policies.<sup>3</sup> Key among these was the need to privatize while encouraging competitive new enterprises and discouraging the continuation of former state enterprises. The World Bank identified a number of reforms that successful transition economies had undertaken, including:

- macroeconomic stabilization;
- price and trade liberalization;
- the imposition of hard budget constraints on banks and enterprises;
- an enabling environment for private sector development;
- a reform of the tax system and restructuring of public expenditure;
- legal and judicial reform; and
- reform of public sector institutions.

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<sup>2</sup> U.S. Department of State, *Background Note: Cuba*, Bureau of Western Hemisphere Affairs (November 2003).

<sup>3</sup> The International Bank for Reconstruction and Development/The World Bank, *Transition: The First Ten Years, Analysis and Lessons for Eastern Europe and the Former Soviet Union* (Washington, D.C., 2002).

In addition, the World Bank noted that success in a transition means the ability to generate economic growth. This in turn was dependent upon a number of factors that, in their totality, were conducive to encouraging the growth of new enterprises while, at the same time, assisting in the process of privatizing state enterprises. These included:

- developing a favorable climate for domestic and foreign investors;
- securing property and contract rights;
- providing basic infrastructure;
- reducing excessive marginal tax rates;
- simplifying licensing and regulatory procedures; and
- developing a competitive and efficient banking system.

This chapter deals with several of these factors.

## **B. Stabilize the Economy, Decontrol Prices, and Begin to Denationalize State-Owned Entities**

Stabilizing and liberalizing the economy are fundamental preconditions for economic growth and for the creation of a viable free market economy. A free Cuba should design a macroeconomic stabilization program to ensure price stability and to anchor the expectations of its population. A stable macroeconomic environment is a necessary precondition to support high levels of investment and productivity growth. The core components of a stabilization policy include sound fiscal and monetary policies that limit deficits to sustainable levels and limit the monetary financing of these deficits. Closely linked to the monetary policy is a decision over the exchange rate regime, which will be the decision of the Cuban transition government.

Prices in today's Cuba remain substantially state-controlled, distorting economic decision-making and leading to a misallocation of resources. Decontrolling pricing is essential to enabling the free market to allocate resources and production decisions and thereby stimulate growth.

In order to implement these policies, a free Cuba will need an effective Finance Ministry and Central Bank, as well as effective tax collection. External technical assistance will likely be available, both through the U.S. Government and IFIs, to support the design of these policies and their implementation.

Privatization of state-controlled enterprises can help consolidate private property rights, stimulate the economy, and provide the basis for the enterprises to run efficiently. Careful thought and consideration should go into how state-owned enterprises will be privatized, whether it will be through a voucher system, public bidding process, management-employee buyout, or targeting of strategic investors. Each method has both positive and negative benefits and it is feasible to use a combination of these methods in the privatization process. For example, small enterprises could be sold quickly through a public bidding process to new owners. This has the benefit of unleashing an entrepreneurial spirit and encouraging a sector that will provide most of the growth and job creation during the early years of transition. Agricultural cooperatives could be sold to their members, which is a form of a management-employee buyout. Other agricultural enterprises could target sales to strategic outside investors who have the experience, resources, and know-how to restructure the enterprise and make it economically viable. Whatever method(s) a free Cuban government chooses, the rules for privatization must be clearly established and the process should be transparent.

Any efforts to privatize state-owned or -controlled entities will have to come to terms with the undue influence of the military in Cuba's economic life. The Cuban military (FAR) controls a large percentage of Cuba's present-day economy. More than 230 factories and firms are included in the Union of Military Enterprises. In addition, current or former FAR senior officers control several key ministries, among them are Sugar, Transport and Ports, and Information Technology and Communications. Tourism, civil aviation, and the marketing of cigars and other tobacco products are controlled by the military. Likewise, active and retired officers also manage banks, the state electronics monopoly, and other key economic sectors. According to one study, these enterprises account for 89 percent of exports, 59 percent of tourism revenue, 24 percent of productive service income, 60 percent of hard currency wholesale transactions, 66 percent of hard currency retail sales, and employ at least 20 percent of state workers.<sup>4</sup>

Beginning in the mid-1980s, the FAR introduced a new management system, the *Sistema de Perfeccionamiento Empresarial*, into many of its military enterprises. The goals of this new system ranged from promoting greater self-

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<sup>4</sup> Domingo Amuchastegui, "FAR: Mastering Reforms," in *Cuba in Transition*, Volume 10, Association for the Study of the Cuban Economy (August 2000).

sufficiency to increasing efficiency and productivity in FAR enterprises. In October 1997, *Perfeccionamiento Empresarial* was adopted as the Cuban Communist Party's official policy to guide restructuring of the Cuban state economic system.<sup>5</sup> *Perfeccionamiento Empresarial* trains executives, managers, and advisers at European, Japanese, and Western Hemisphere universities and business schools, but it is a long, drawn-out process involving many layers of bureaucratic review and control. As a result, to date, only a handful of enterprises have completed the entire process.

According to one analyst, these enterprises appear to function as protected monopolies entrusted to regime favorites, picked more for their loyalty than their competence. Some evidence suggests that the regime may also tolerate some level of corruption in their operation to allow trusted officials to increase their own standard of living.<sup>6</sup> Finally, there exists no clear evidence that military managers have succeeded in meeting the *Perfeccionamiento Empresarial* goal of introducing greater efficiency and productivity into their operations. The sugar industry in particular has consistently experienced historically poor harvests since its take-over by the military. Nevertheless, the *Perfeccionamiento Empresarial* process has developed an educated professional core with some understanding of market principles. It has also introduced the prospects, at least in theory, of market economics into Cuba's closed economic system. However, the military's extensive involvement in the Cuban economy also may have created a vested constituency dedicated to maintaining the current closed economic structure.

Many of Cuba's medium and large enterprises will need to be restructured, with corporate governance methods put in place to enhance their value prior to any privatization. When assessing the value of Cuba's state-owned/controlled enterprises, the value should take into account the viability of the enterprise and not the circumstances of the current state of the Cuban economy. The United States and the IFIs can offer assistance to a free Cuba to help it design an effective privatization program as well as prepare specific enterprises for privatization.

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<sup>5</sup> Ibid.

<sup>6</sup> Brian Latell, *The Cuban Military and Transition Dynamics*, Cuba Transition Project, Institute for Cuban and Cuban-American Studies (University of Miami, 2003).

## RECOMMENDATIONS:

- *The U.S. Government should encourage the IFIs to engage with the Cuban transition government to design and implement an effective economic strategy that includes sound macroeconomic policies, price liberalization, deregulation, investment climate and legal reforms, and privatization.*
- *The U.S. Government and the IFIs should offer assistance to a free Cuba to help it design an effective privatization program as well as prepare enterprises for privatization, including industries and enterprises operated or managed by the Cuban Armed Forces.*
- *The U.S. Government should provide examples to a free Cuba from Eastern Europe concerning that region's experiences in transitioning from a centralized economy, including experiences with the restructuring of enterprises controlled by militaries.*

### C. Trade

A renewed trade relationship with the United States and Latin American partners will be critical to developing and sustaining a free Cuban economy. In 1958, despite its small economy, Cuba was a relatively important U.S. trade partner, ranking as the 7<sup>th</sup> largest U.S. export market and the 7<sup>th</sup> leading source of U.S. imports. Even under the most optimistic assumptions, this position is not likely to be replicated anytime soon. Cuba today is a relatively minor actor in the multilateral trade arena, with 2002 exports of about \$1.6 billion (mostly in sugar and nickel).

The composition of Cuban exports has changed substantially in recent years. Sugar, once the mainstay of the Cuban economy, has declined in both absolute and relative terms. Tourism has emerged as the number one hard-currency earner for the Castro regime, having surpassed sugar exports as a revenue source in 1994. The U.S. International Trade Commission, in a study examining the effects of the U.S. embargo on both Cuba and the United States, identified several sectors where the United States might be able to realize small, but important near-term gains in

trade and investment with Cuba if trade relations were normalized (and all-important financing was made available).<sup>7</sup> These sectors included:

- maritime transportation;
- tourism; and
- exports of wheat, rice, and fats and oils.

Similarly, the Commission noted several sectors for which normalization of trade relations would have a potential impact on U.S. industry. Some positive aspects include access to less expensive nickel and cobalt. At the same time, U.S. industries could lose market share in citrus, sugar, and perhaps cigars.

Clearly, one of the first steps to be taken as part of the re-establishment of a full official U.S. presence in a free Cuba should include a permanent U.S. Government Foreign Commercial Service. This entity would play the vital role of serving as an information clearinghouse for U.S. business executives; as a point of contact for requests for meetings with the proper Cuban transition government agencies; and in identifying joint venture, investment, and trade partners.

Because the demands for information and for business services are expected to be large once a transition is underway, and because it will involve the participation of many U.S. Government agencies, a new embassy should include representation from other agencies. For example, the United States should explore having representatives from the Small Business Administration (SBA), the Overseas Private Investment Corporation (OPIC), and Export-Import Bank (EXIM Bank) co-located to create a type of one-stop shop for business executives. Because Florida will probably be a principal jumping off place for Cuba, a mirror operation could be established in Miami to provide similar information before executives depart for Cuba.

The U.S. Government should be prepared to include members of the Foreign Agricultural Service in a new U.S. embassy in a free Cuba. Having such a presence will enable the U.S. Government to coordinate development activities in the agricultural area and foster increased trade opportunities for both countries.

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<sup>7</sup> United States International Trade Commission. *The Economic Impact of U.S. Sanctions with Respect to Cuba*, Investigation 332-413 (Publication 3398; February 2001).

It is important to work with both a free Cuban government and a Cuban private sector to assist them in developing new markets for their products and new products that are up to acceptable standards. To that end, the National Institute of Standards and Technology should be prepared to provide technical assistance in the standard's area and the Patent and Trademark Office should be prepared to position itself to provide technical assistance in the area of intellectual property rights protection.

The U.S. Government and its regional partners should also consider working with other hemispheric economies to reintegrate a free Cuba rapidly into the regional trading system that has developed over the past two decades. As a first step, the U.S. Administration in office at the start of transition should request the U.S. International Trade Commission to undertake a *Probable Economic Effects* study focusing on the likely impact on U.S. industry and agriculture of integrating Cuba into the Caribbean Basin Economic Recovery Act (CBERA). The report could be used as guidance toward eventually reviewing eligibility for preferential treatment to Cuban products under CBERA and under the U.S. Generalized System of Preferences (GSP). The U.S. Government should also consider steps Cuba will need to take in order to meet U.S.-Cuba Free Trade Agreement standards and work with Cuba to identify appropriate assistance, including from multilateral and other bilateral sources. The goal would be to set Cuba on the path to eventual negotiation of a U.S.-Cuba Free Trade Agreement. A free Cuba should also be encouraged to solidify its regional trade ties with its Latin American and Caribbean neighbors and to tap regional neighbors' trade expertise.

Trade capacity building has emerged as a key component in support of U.S. efforts to liberalize trade in the world and, in particular, the Western Hemisphere. The President's 2001 International Trade Agenda emphasized the need to "help developing countries and emerging markets begin the process of integrating themselves into the world trading system." Since that time, trade capacity building activities, implemented by a broad range of U.S. Government agencies, have assisted developing and transition countries to participate in and benefit from expanding global trade. In FY02, U.S. trade capacity building assistance to the Americas totaled more than \$90 million, up from \$61 million in 2001. Trade capacity building efforts range from providing technical assistance directly to governments aimed at increasing understanding of World Trade Organization (WTO) commitments, to facilitating trade by lowering the costs of doing business. These elements are important elements of the Free Trade Area of the Americas

(FTAA) negotiations, as well as within the ongoing or planned free trade agreement negotiations with Central America, the Dominican Republic, Panama, and the Andean Community.

## **RECOMMENDATIONS:**

- *The U.S. Government should be in a position to work with a free Cuba to establish a U.S.-Cuba Joint Committee on Trade and Investment (JCTI). The JCTI would focus on post-embargo relations affecting trade and investment. It would also serve as a precursor and first step toward the possible negotiation of a U.S.-Cuba Free Trade Agreement.*
- *The U.S. Government should be prepared to establish a Foreign Commercial Service presence as part of our Embassy in a free Cuba in order to provide information to and establish contacts for U.S. companies interested in exporting to or investing in Cuba.*
- *The U.S. Government should be prepared to move rapidly to establish a U.S. Department of Agriculture (USDA) presence as part of our embassy in a free Cuba. Specifically, USDA's Foreign Agricultural Service (FAS) should be prepared to establish an Office of Agricultural Affairs (OAA) in a re-opened U.S. embassy. USDA's Animal and Plant Health Inspection Service (APHIS) should be in a position to establish an office alongside the OAA to lend its support to USDA animal and plant health activities, all of which will be essential in the early stages of a new government.*
- *The U.S. Government should encourage its regional allies to consider including a free Cuba in its free trade arrangements.*
- *The U.S. Government should offer to provide technical assistance to a free Cuba by the National Institute of Standards and Technology in the area of standards and encourage the Patent and Trademark Office to provide technical assistance in the area of intellectual property rights protection. The U.S. Government should also encourage a free Cuba to seek complimentary assistance from multilateral institutions.*
- *The U.S. Government should encourage a free Cuba to involve its newly emerging private sector in an advisory role on future trade matters. By doing*

*so, Cuba would help to establish an environment conducive to private sector-led growth, as it would ensure that the needs of business are properly addressed and taken into account by government regulators.*

- *The U.S. Government should be prepared to extend its trade capacity building activities, including customs cooperation, to a free Cuba, with a principal focus on the island's transition to a free market system and on encouraging efficient and secure trade between the United States and Cuba.*
- *The U.S. Government should offer to help a free Cuba upgrade and expand its use of free trade zones as a means to attract investment and expand trade. Free trade zones are used throughout Latin America and Asia, where they have proven to be attractive to investors because they rationalize resources and improve productive efficiency.*
- *The U.S. Government should be prepared to establish an aviation relationship with Cuba (as discussed in Chapter 5, section IV) based on Open Skies principles. This would provide valuable benefits to U.S. and Cuban shippers, travelers, and air carriers.*

#### **D. Rejoin International Financial Institutions (IFIs) and Other International/Regional Institutions**

Cuba is not a member of the institutions of the international financial community. To join these organizations requires a majority vote by the Board of Governors (or equivalent) of each institution. Membership is strictly sequential: first, Cuba would need to achieve membership in the IMF, then the World Bank, and finally its regional IFI, the Inter-American Development Bank (IDB). IMF and World Bank membership is a prerequisite for debt reduction in the Paris Club.

As a member, a free Cuba would be required to subscribe to its quota share in a combination of local and convertible currencies. That membership subscription would provide the basis for future lending. Lending from the IMF could take place through different facilities, depending on the circumstances on the ground in Cuba. The IMF could undertake some activities to support Cuba before it was admitted to the Fund, including providing technical assistance and some informal activities. The IMF's relationship with West Bank/Gaza Strip is one example of its technical assistance activities.

Cuba will also need assistance from the Organization of American States (OAS) in adhering to the principles and aspirations regarding democracy and human rights expressed in the Inter-American Democratic Charter approved on September 11, 2001. Although Cuba is a member state of the OAS, the Castro government is suspended from active participation in the organization. The Cuban government will therefore need to reestablish its qualifications for a return to active participation in the OAS. Further, the suspension of the government of Cuba must be withdrawn before it can join the IDB.

Lending from the World Bank and the Inter-American Development Bank is generally carried out in the context of a three-year country assessment strategy (CAS). A CAS can take up to several months, although that period could undoubtedly be expedited if Cuba were determined to have substantial needs for immediate assistance. A critical factor in determining the interest rate associated with any such lending would be Cuba's per capita income levels.

#### **RECOMMENDATIONS:**

- *The U.S. Government should encourage a free Cuba to rejoin the IMF, World Bank, and OAS, and join the IDB as quickly as possible.*
- *The U.S. Government should encourage the IFIs to engage with the new Cuban government to design and implement an effective economic strategy that includes a range of macroeconomic and microeconomic reforms to provide the basis for sustained growth.*
- *The U.S. Government should encourage the IFIs to provide a free Cuba with technical assistance in a variety of areas, including privatization, where the World Bank in particular has extensive expertise based on its study of transitions in a number of former non-market economies.*

#### **E. Encourage Foreign Investment**

To keep itself afloat, the Castro regime actively courts foreign investments, which take the form of joint ventures (with the Cuban government often holding half or more of the equity) or management contracts with third-country businesses.

A new legal framework laid out in 1995 (Law No. 77) introduced a number of modest changes to Cuba's foreign investment regime, but significant restrictions are still in place.<sup>8</sup> For example, approval for all foreign investment is still required on a case-by-case basis. Firms may only contract with a designated state labor supply agency for workers, and the state is responsible for disciplining workers and resolving labor-management disputes. Although the law also allowed for majority foreign ownership in joint ventures with the Castro government, in practice, majority ownership by the foreign partner is practically nonexistent.

The number of joint ventures formed each year has been steadily declining since 1997, and foreign direct investment flows decreased from \$448 million in 2000 to \$39 million in 2001, with little prospect for near-term improvement. Of the 540 joint ventures formed since the Cuban government issued the first legislation on foreign investment in 1982, 397 remained at the end of 2002. According to Granma online, 342 still operated at the end of 2003. Many of these investments are management contracts, or special arrangements regarding supplies, or the provision of services normally not considered equity investment in Western economies. European companies have grown increasingly frustrated with what they perceive as arbitrary investment rules, excessive paperwork requirements, and uncertain payment schedules. In 2002, a group of European Union embassies in Havana presented a list of complaints to the Castro government of the difficulties faced by European businessmen operating in Cuba. Presented as a constructive exercise by the Europeans, the initiative angered the Castro government.

A number of issues that are a consequence of Cuba's current foreign investment regime will need to be examined. For example, the sale or transfer of investors' capital to third parties is subject to Cuban government approval. This failure to provide a viable "exit strategy," unless changed, will undoubtedly have a chilling effect on future foreign investment. Law 77 also failed to settle the issue of investor certainty. Article 3.3 of the Foreign Investment Law continues to leave open the possibility of Cuban termination of investment agreements seemingly at will and without due process or adequate compensation. Moreover, the inability to

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<sup>8</sup> Robert David Cruz, *Foreign Direct Investment in Post-Castro Cuba: Problems, Opportunities and Recommendations*, Cuba Transition Project, Institute for Cuban and Cuban-American Studies (University of Miami, 2003).

hire workers directly is another feature of the current investment regime that will need to be altered.

Ensuring protection for intellectual property and pursuing vigorous enforcement of IPR laws and regulations will be one key to attracting additional foreign investment. In May 2000, Cuba's IPR law was modified by Decree-Law 203 for Trademarks and Other Distinct Signs. This was designed to bring Cuba into conformity with the WTO TRIPs agreement.<sup>9</sup>

Cuba is a member of most multilateral international treaties in effect relating to IPR law, including the Paris Convention, the World Intellectual Property Organization, and the Bern Convention. Since Castro came to power, both the U.S. and Cuba, as parties to the 1929 General Inter-American Convention for Trademarks and Commercial Protection, have reciprocally recognized trademark rights.

In terms of patents, Cuba, which developed its pharmaceutical industry by more than occasionally violating international patents, is today a staunch defender of its own IPR with some 500 patents registered around the world. As a consequence, Cuba has developed joint ventures in biotechnology and pharmaceuticals in a number of worldwide markets, particularly in developing markets. For example, a recent joint venture in Malaysia will eventually produce biotechnology products for Southeast Asian markets.

## **RECOMMENDATIONS:**

- *The U.S. Government and the international financial institutions should be prepared to assist a free Cuba in developing a new investment regime that fosters foreign investment and investor confidence, consistent with appropriate free market mechanisms.*
- *If progress can be made on a process for settling outstanding claims and the establishment of a sound policy and legal framework for foreign investment, the U.S. Government should consider complementing this by negotiating a Bilateral Investment Treaty with a free Cuba at the earliest possible time.*

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<sup>9</sup> Jesus (Jay) Sanchelima, "Selected Aspects of Cuba's Intellectual Property Laws," in *Cuba in Transition*, Volume 10, Association for the Study of the Cuban Economy (August 2000).

- *The U.S. Government should encourage a Cuban transition government to provide assurances that it will continue to uphold its obligations under international intellectual property agreements. Doing so early in the process would be an incentive to foreign investment and thereby facilitate Cuba's move to a free-market economy.*

## **F. Reschedule External Debt**

Cuba's precarious economic position is complicated by the high price it must presently pay for foreign financing. The Cuban government defaulted on most of its international debt to Western countries in 1986 and does not have access to credit from international credit institutions. This means Havana must rely heavily on short-term loans to finance imports, chiefly food and fuel. Because of its poor credit rating, a \$12.2 billion hard currency debt, and the risks associated with Cuban investment, interest rates have reportedly been as high as 22 percent.

In 1995, Cuba restarted informal contacts with the Paris Club of Creditor Nations for possible rescheduling agreements of its external debt. Cuba has bilaterally negotiated a number of rescheduling agreements with some of its official and commercial creditors, including a 1998 rescheduling with Japanese creditors for \$769 million. However, it defaulted on this agreement in October 2002. At the same time, Cuba suspended all payments on the \$380 million owed to Bancomext, the Mexican government's export financing bank. In May 2003, the Spanish government acknowledged in response to a Spanish parliament inquiry that Cuba is Spain's top foreign debtor government, presently in default on an estimated \$816 million. Cuba's outstanding debt to the U.S. Government is approximately \$36.2 million, not including late interest. The entire amount is in arrears. The Paris Club works on the consensus of its 19 member creditor countries and requires the debtor to have an IMF arrangement with strong policy reform conditionality in order to be eligible for debt treatment.

A free Cuba will need to normalize relations with its external creditors. This would involve a number of actions by Cuba and the international community, including an effort to reschedule Cuba's debt, including arrears, and establish conditions whereby Cuba might resume making debt service payments in accordance with its financial capacity. Multilateral debt rescheduling would require an IMF program, according to longstanding Paris Club practice. This,

along with economic reforms, would likely accelerate the flow of new money into Cuba.

#### **RECOMMENDATIONS:**

- *The U.S. Government should encourage both the World Bank and IMF to provide loans to a free Cuba, if needed.*
- *The U.S. Government, working with its allies, should offer to assist a free Cuba in securing debt relief from its major creditors. It should also offer to help Cuba in securing donor aid from other sources (e.g., the EU).*

#### **G. Trade Financing/Credits**

The rapid rise of small- and medium-sized private-sector enterprises will be a key determinant in the success or failure of a transition government's economic reconstruction and development programs. Cuba's export sector will play a critical role in sustaining economic growth and ensuring job creation. A number of institutions and sources may be looked to, including the Cuban-American community, to provide financing for Cuban exporters. Some of these are discussed in greater detail below.

In addition, consideration should be given to reviving a program used during the late 1980s and early 1990s in Central America by the U.S. Agency for International Development (USAID) and the EXIM Bank to provide badly needed trade financing. Specifically, the U.S. Government should consider reinstating for Cuba the "trade credit insurance program" under which USAID, in FY1985, was authorized to issue guarantees to the EXIM Bank of up to \$300 million for export credit insurance authorized by the EXIM Bank to support U.S. exports to the private sector in Central America on repayment terms of up to one year. The program ended on September 30, 1991.

#### **RECOMMENDATIONS:**

- *The U.S. Government should work with the multilateral development banks, NGOs and other interested parties in assisting a free Cuba to gain access to short term financing for trade.*

- *The U.S. Government should consider reauthorizing the trade credit insurance program for a free Cuba.*

#### **IV. MEDIUM- AND LONG-TERM ACTIONS**

##### **A. Settle Outstanding Expropriated Property Claims**

###### **1. Background**

Settling the issue of expropriated properties will be critical to a transition Cuban Government. It will be seen by many as a signal that Cuba will be open for normal business once again. Potential investors will be reluctant to get involved in Cuba as long as questions of ownership, property rights, and restitution remain unsettled. The longer this issue remains open, the longer it will take for Cuba's financial and economic recovery. This will be especially true in cases of the ownership and clear title of commercial property. As progress is made in this area, so will progress be made in getting businesses established, jobs created, and the economy growing.

It will not be easy. The challenge is complicated by a variety of factors. There are multiple claimants (companies and individuals, U.S. and non-U.S. nationals), different types of properties (commercial, agricultural, and residential) and existing foreign companies operating through joint ventures in expropriated facilities. In many cases, records may have been lost, altered, or otherwise prove difficult to confirm ownership or clear title. Also, a Cuban transition government will have finite resources to devote to compensation payments.

Eastern European and former Soviet states provide a number of recent examples dealing with expropriation. Eastern European countries followed one of two models — restitution or compensation — during this difficult process. Restitution involved the return of the expropriated property to the original owner. In the case of residential property, it often required that the original owner take physical control (i.e., live in) the returned property. In cases where restitution was not possible, the original owners were compensated either in whole or in kind (in cash, bonds, or vouchers), or in part. Compensation, on the other hand, provided payment to the former owner for the expropriated property. In some instances, a mixture of the two approaches was used.

## **2. Commercial Property**

It will be important to establish a process to settle commercial property claims without disrupting jobs and distribution systems. At the outset of a transition, it is likely that all state enterprises and joint ventures will continue operating as though everything were normal, until clear ownership and titles are established, so that payrolls continue to be met and goods and services continue to be provided. This process will be complicated by the fact that some expropriated properties are presently hosting joint ventures with third parties. The fate of joint venture contracts between the Castro regime and third-country businesses should be addressed by a new Cuban government. As the legal owner of each property is determined, a transition government will need to maintain an environment for a smooth titling of those properties.

## **3. Residential Property**

The situation involving residential property will be extremely complex. Castro has been telling Cubans for years that the end of communism will result in a mass of exiled Cubans returning to Cuba to claim their homes. The specter of mass evictions that this raises is compounded by estimates that Cuba already suffers from a tremendous housing shortage (around 1.6 million units), and that much of the existing housing is substandard, particularly as one moves further out from Havana.<sup>10</sup> The issue of residential housing raises the potential for major political dissatisfaction by a large segment of Cubans at the start of a transitional government. Moreover, housing will be one of the major avenues for average Cubans to begin realizing their dreams via homeownership and, in particular, the equity benefits of owning a major piece of collateral. Clear title to property is a major step toward promoting individual entrepreneurship, bringing people into the formal economy, and providing them with a stake in the island's future.

Whichever path is eventually chosen — restitution, compensation, or some mix of the two — the experiences from Eastern Europe demonstrate the advantages of proceeding quickly and of placing an emphasis on using the process, in conjunction with privatization, to develop small- and medium-sized enterprises.

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<sup>10</sup> Carmelo Mesa-Lago, *Growing Economic and Social Disparities in Cuba: Impact and Recommendations for Change*, Cuba Transition Project, Institute for Cuban and Cuban-American Studies (University of Miami, 2003).

A strong, economically viable middle class will be essential to forming a stable government and economy.

#### **4. Intellectual Property**

Under current U.S. law and regulations, the Cuban government and its entities have generally been permitted, under license, to register trademarks and logos with the U.S. Patent and Trademark Office (USPTO). Cuba has registered trademarks in the United States for a number of goods. A number of trademarks are in dispute currently over ownership. This is an area that will need to be addressed promptly during a transition in Cuba.

#### **5. One Approach for Dealing with Expropriated Real Property**

The U.S. Government, if requested by a transition Cuban government, could help establish a structure for addressing property expropriations. Creation of a Commission on the Restitution of Property Rights (CRPR), Property Claims Courts, and a Supreme Commission on the Restitution of Property Rights under the supervision of a new Cuban Supreme Court, could form the framework for such property resolution process. This structure could establish entities, such as the CRPR and Property Claims Courts, at the local/provincial level, which might expedite the process, as it would allow local transition officials, who are more familiar with issues in the province, to have a greater voice in the property issues, which in turn could contribute to future provincial viability. The process could be governed by the following guidelines:

- All title to real property should temporarily remain with a free Cuban government, or whoever has current title, until this process determines who has clear title.
- Any damage to the property before a final ruling should be dealt with as an offense against a free Cuban government.
- Those eligible to file a claim should include all Cuban nationals who lost title or possession of real property without due compensation, and U.S. nationals whose claims were certified by the U.S. Foreign Claims Settlement Commission (FCSC) and nationals of other foreign countries who have

legitimate rights and interests in real property. No distinction should be made as to whether Cuban nationals left or stayed in Cuba during the Castro regime.

A CRPR should be required to reach a settlement agreement between the parties as quickly as possible, perhaps within a year from the initial filing. Potential claimants should be required to file initial claims for ownership within a specific time frame (e.g., six months). Once all parties have submitted their claims, the CRPR might be given another specified period (e.g., three to six months) to consider the matter. If, after this time period, the initial claim is uncontested, the claimant should be adjudged to have the right to compensation or restitution, as reasonably appropriate, with respect to the property in question. Title to the claim would either pass to the claimant or remain with the state, as the case may be, but in any event it would be clear, and immune to challenge.

A CRPR should have the power to determine (a) who has title; (b) whether the property should be returned to the title holder, remain with the state for reasons of public interest or necessity, or be awarded to the current occupant; (c) what conditions might be appropriate as to the use and/or conveyance of the property if it is to be returned to its former owner, and what obligations the new owner may assume; (d) what compensation should be given to the former owner if the property is not returned; and (e) what compensation is to be given to other parties with an interest in the property (e.g., foreign investors) and on what conditions.

With regard to commercial property claims, a CRPR goal should be to establish the legal owner and return possession as soon as possible. A free Cuban government may wish to consider allowing the CRPR to offer compensation (whether in the form of cash, bonds, or vouchers) to bona fide purchasers of full or partial rights and interests in property.

With regard to claims involving residential property, in cases where the CRPR finds in favor of the former owner, temporary tenant restrictions should be permitted to avoid undue hardship on current occupants. If the CRPR finds that the property is occupied as a home, then the claimant should be unable to evict the tenants and take possession of the property for a specified period of time. Additionally, the owner will be restricted as to how much rent to charge the tenants or in the amount of any increases in their rents. These restrictions may be waived by mutual consent of the owner, the tenants, and the CRPR. This waiver or release

of the tenant's restrictions may be secured by contract with consideration to the tenants from the decreed clear title owner with permission of the CRPR.

If a settlement agreement cannot be reached, then the case should be referred to the Property Claims Court for adjudication. The Property Claims Courts would serve as the initial appeals court in cases involving property claims that were not resolvable at the Commission level. The Supreme Commission in Havana would serve as the arbiter of last resort, and have the discretion to consider appeals and review rulings of a Property Claims Court. It could have the authority to reverse Property Claims Court decisions, or remand them for further consideration. Finally, the Supreme Commission could decree a final clear title to the owner.

### **RECOMMENDATIONS:**

- *The U.S. Government should encourage a free Cuba to indicate at an early stage in the transition, and in the strongest possible terms, Cuba's intent to settle the expropriation issue as quickly as it can and in an open and fair manner.*
- *The U.S. Government should encourage a free Cuba to settle outstanding claims issues as expeditiously as possible, bearing in mind that a long, complicated process is not in Cuba's best economic interest.*
- *The U.S. Government should be prepared to work with a free Cuba to establish a mechanism that is open and transparent to resolve property claims. A mechanism that is perceived as fair and free from political influence will be critical to ensuring that the process works quickly and creates a minimum of residual hard feelings.*
- *In the area of trademarks and patents, the U.S. Government should be prepared to assist a free Cuba to develop a modern trademark and patent registration mechanism and appropriate legal protections. The U.S. Government also should work with a Cuban transition government to address trademarks and patents in dispute.*

## **B. Rekindle Entrepreneurship and Private Enterprise**

### **1. The Role of Remittances**

A post-Castro transition in Cuba will not enjoy the luxury of time to address the immediate challenge of an unemployed/underemployed population, estimated at 12 percent of the island's current four million active workforce.

Judging by the failure of the current Cuban regime to generate new jobs (as evinced by the displacement of over 100,000 agricultural and blue-collar sugar industry workers who continue to receive salaries while attending vocational or university courses), political and social stability in a transitional post-Castro Cuba will depend to a great extent on the ability of a fledgling private sector to provide meaningful livelihoods for the Cuban people.

While Cuba has an educated and technically skilled work force, the island will nonetheless begin a transition in a state of impoverishment. Foreign direct investment (FDI) by multinational companies will likely be directed toward larger state-owned enterprises undergoing privatization while IFI loans will be necessary to rebuild the island's public infrastructure. In other words, conventional sources of capital and schemes of foreign aid will not resolve the critical underemployment that afflicts the Cuban economy today and that will only be aggravated by the collapse of the Castro regime's statist policies.

As with other aspects of a transition, the Cuban-American community could play a pivotal role in job creation on the island. At present, remittances from Cuban-Americans are estimated by the Inter-American Development Bank at over US\$1 billion a year and constitute the second largest source of foreign exchange for the Castro regime, second only to tourism. It is estimated that the Cuban-American community may have assets worth as much as \$40-\$50 billion. Even if a relatively modest share of the combined assets of Cuban-American firms were invested in a post-transition Cuba, they would dwarf the estimated \$2 billion in foreign investment received by Cuba since the early 1990s.<sup>11</sup>

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<sup>11</sup> Sergio Diaz-Briquets and Jorge Perez-Lopez, *The Role of the Cuban-American Community in the Cuban Transition*, Cuba Transition Project, Institute for Cuban and Cuban-American Studies (University of Miami, 2003).

As noted in Chapter 1, remittances today serve two purposes: a means of meeting the basic consumer needs for Cubans fortunate enough to have relatives and loved ones abroad and a significant source of revenue for the repressive regime. In a transitional economy, remittances could serve as the start-up capital for reviving self-employment and small enterprises on the island.

## 2. Microfinancing

Given the urgency — economically as well as psychologically — of addressing the immediate needs of the population, creating and implementing a microfinancing program should be paramount. In this process, the Cuban-American community in general, and the Cuban-American business establishment in particular, could be called upon to capitalize microdevelopment funds for start-up enterprises on the island. For example, the early success of *paladares* (home-based restaurants) and *casas particulares* (home-based boarding establishments) in the mid-1990s reveal what enterprising Cubans can accomplish when given an incentive, even under an intolerant and repressive regime. It should be recalled that a number of *paladares* and *casas particulares* were initially financed by remittances from those in the U.S. with enterprising relatives on the island. Access to such start-up capital would be greatly expanded with the presence of microfinancing institutions, especially for those Cubans who do not have relatives abroad.

Microfinancing institutions are not humanitarian or charitable organizations, and the availability of their funds should be seen as an investment in specific ventures. This will hopefully encourage venture capitalists and financial institutions to view microfinancing as a low-risk option to invest in Cuba.<sup>12</sup>

Microfinancing is also the most effective form of public-private partnerships to foster the growth of small- and medium-sized enterprises. A concrete example that could certainly be emulated and replicated in Cuba is the work of the Enterprise and Growth Foundation (*Fundación Empresa y Crecimiento* or FEC) in Mexico. Funded by multinational Spanish companies operating in Latin America, including *Telefonica* and *Santander* Bank, this foundation seeks to address the

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<sup>12</sup> *The New York Times*, “Banking for the World’s Poor,” (November 19, 2003). Case-in-point: During the Asian financial crisis, a leading bank in Indonesia lost only 2 percent in defaults from among its microenterprise portfolio, but almost 100 percent in its corporate portfolio.

need for financing of small- and medium-sized business ventures in Mexico. Within six months of beginning its work, the FEC was evaluating more than 100 projects. The investment fund, currently valued at US\$17 million, is professionally managed by Mexican nationals rather than by the foreign investors. According to FEC, three ventures have been approved for a total disbursement of US\$6 million and have generated some 500 jobs in Mexico over the six-month period. Due to the success of the microfinancing program, the Mexican government's *Nacional Financiera* (NAFINSA) development bank and the IDB have joined in supporting the program.

While no one scheme will be a panacea for Cuba, certainly such public-private partnerships offer a feasible approach for reviving private enterprise in a cash-strapped Cuban economy and rapidly creating employment opportunities.<sup>13</sup>

### **3. Partnerships**

In addition to its role in providing potential financial resources to Cuba, the Cuban-American community might provide other forms of badly needed assistance. For example, business networks between the Cuban-American community and their Cuban counterparts could do much to help foster trade. Informal contacts between interested business associations could be used to overcome informal barriers that inhibit trade, such as weak enforcement of international contracts and inadequate information about trading opportunities.

In addition, the Cuban-American business community could effectively energize the small business sector in Cuba. The management, production, and technical know-how of the Cuban-American community could inject life into an emerging Cuban small business sector in a relatively short time. Moreover, Cuban-American firms could also play the role as “first movers”: investors who could enter the Cuban market early in the transition and by their presence and example change market expectations and advance the flow of foreign direct investment from more conventional sources.

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<sup>13</sup> Marcelo Risi, “Capital para los pequeños,” *BBC Mundo* (September 2003).

#### 4. Small and Micro Enterprises

In the United States, small business accounts for 50 percent of jobs, 40 percent of GDP, 30 percent of exports, and one-half of technological innovations. These businesses provide the basis of a middle-class life for millions of people. The emergence of small- and medium-sized private-sector enterprises in a free Cuba will determine success or failure of reconstruction and development programs. A Cuban transition government should consider what policies it can implement to generate small and microenterprise (SME) development.

Microenterprise versus Small Business. In developing countries, microenterprise is part of a strategy of poverty alleviation, typically based on the village lending approach pioneered by Grameen Bank. Not necessarily an end in itself, microenterprise development can increase awareness of the negative circumstances of a country's business environment that force would-be business owners into the inefficient informal sector. Once this is recognized as a problem, steps can then be taken to formalize the informal sector as a country considers how to move from microenterprise to small business. Creating a supportive environment for small business involves improving the legal, regulatory, and judicial environment (commercial law, contract law, etc.), financial sector improvement, commercial banking reform, small business managerial training, and so on.

Applicable SME Model for Cuba. Two small and microenterprise development models might be applicable to a free Cuba. The first is Latin America; the second are transition countries moving from socialism to a market-based economy, as is the case in Eastern Europe and the former Soviet republics. In Latin America, in 2003, the U.S. Small Business Administration (SBA) started a network of SME agencies in the Western Hemisphere called the *SME Congress of the Americas* to serve as a forum for sharing ideas on the SME experience among Latin American nations. In a post-Castro environment, Cuban engagement with this group would be useful.

In the case of the former socialist countries of the Soviet Bloc, there are several country experiences to consider. Poland, Hungary, and the Czech Republic made relatively rapid transitions, creating an enabling environment for SMEs and ultimately economic integration with the EU. These former socialist countries share their experiences at the *SME Working Party of the OECD*, to which SBA has

been a contributor. Compared to Cuba, however, these are relatively affluent countries; so the SME experience of the poorer transition countries may offer better examples for Cuba early in a transition.

Applicability of SBA and possible technical assistance to Cuba. SBA is an SME agency wholly oriented toward the United States. Its experience reflects a sophisticated economic environment and first-world SME issues. Nonetheless, the SBA has worked successfully in developing countries. In the past two years, SBA completed more than \$4 million of USAID-funded SME projects in countries such as Nigeria and Egypt. A free Cuba should be considered for the establishment of Business Information Centers (BICs), which are on-the-ground, community-based locations for office support, fax, copying, PC, Internet, business training and applications software, workshops, and advice on dealing with entry-level business problems. SBA recently helped set up BICs in Nigeria.

#### **RECOMMENDATIONS:**

- *The U.S. Government should work with the Cuban-American community and a free Cuba to facilitate the low-cost, speedy transfer of remittances and promote their use to finance self-employment and small business start-ups in Cuba.*
- *The U.S. Government should encourage the Cuban-American community and the larger U.S. investment community to create a “Friends of Cuba” organization that could provide private-sector support to Cuba during transition and assist in promoting microfinancing and a more open flow of goods and services on the island. This organization should focus on bringing entrepreneurs from the United States and Cuba together to promote business relations and establish initial business contacts.*
- *Assistance should be offered to promote microfinancing in Cuba. With assistance from USAID — perhaps a program similar to the partnership with VISA for Central American microfinancing projects — and other aid bodies, joint public-private ventures could pool financial resources and invest in sound business plans by new Cuban entrepreneurs.*
- *The U.S. Government should work with the IFIs to encourage the creation of microfinance enterprises in a free Cuba, similar to those that have been successfully deployed in other developing countries.*

- *The U.S. Government should offer to Cuban entrepreneurs demonstration tours of U.S. small businesses to promote best practices and encourage small business development. The U.S. Government also should be prepared to establish small business mentoring programs to encourage exchanges of successful small businesspersons with their Cuban counterparts.*
- *The U.S. Government should encourage Cuban transition officials to examine the experience of the U.S. Small Business Administration to determine if a comparable entity would be helpful.*
- *In addition, the U.S. Government could offer microenterprise assistance, including exposure to the many community-based lenders that make use of SBA start-up funding.*
- *The U.S. should be in a position to offer to establish Business Information Centers in a free Cuba.*
- *The United States should encourage a free Cuba to participate in the SME Congress of the Americas so that it can learn from the experiences of other Latin American countries in promoting SMEs.*

**C. Establish an Independent Banking System and an Independent Central Bank**

The key objectives for a Central Bank include maintaining price stability through monetary policy, promoting safety and soundness in the banking sector through effective banking supervision, and fostering and maintaining a stable and competitive market-based financial system. A Central Bank needs to be empowered to license and supervise commercial banks as well as other financial intermediaries, such as money transmission companies and foreign exchange bureaus, and operate as a lender of last resort for the existing commercial banks. Depending on a free Cuba's choice of exchange rate regimes, the role for the Central Bank may be more or less limited.

The first task will be to create the legal basis for the Central Bank's independence and operations. However, it will take time to institutionalize this independence in practice.

The private banking system has a traditional role of allocating resources efficiently and stimulating economic growth by intermediating between borrowers and investors. In a properly functioning market economy, a sound banking system fulfills basic functions such as executing payments, implementing monetary policy, mobilizing savings, and intermediating between borrowers and investors.

Part of the foundation for a well functioning banking system is a legal infrastructure to promote a modern competitive banking system, and a supervisor that has the institutional capacity to rigorously monitor the condition of its banks and to resolve problems within an adequate legal and regulatory framework. A properly functioning supervisory system builds: depositor confidence; deeper levels of financial intermediation (thus economic growth); and faster resolution of problems, and at an earlier stage, so that there is little cost to the taxpayer.

Reform will necessarily involve decisions on how to build a private banking system either through entry of new private banks, entry of foreign banks, or privatization of existing state banks. State banks in transition economies have traditionally presented problems, because of large numbers of non-performing loans, links to state enterprises, opaque governance structures, and the dominance of the deposit base. Reform will need to address each of these problems, including auditing the state banking sector, severing links to non-performing borrowers, and preparing the banking system for privatization. It will also need to ensure that the public banks do not inhibit the growth of a private banking system by using its stronger deposit base and likely perception of government backing to offer lower interest rates.

## **RECOMMENDATIONS:**

- *The U.S. Government and the IFIs should be in position to offer assistance to a free Cuba in developing an independent central bank based on its experience with other developing countries in Latin America.*
- *The U.S. Government and the IFIs should offer to provide a free Cuba with technical assistance to develop its banking system, including its regulatory framework and the capacity to supervise the banks.*

- *The U.S. Government should offer to do training in best practices for bank supervisors in a free Cuba.*

#### **D. Build an Effective Finance/Economy Ministry**

An effective finance ministry will be needed to conduct fiscal policy, oversee the budget process, manage the debt, and coordinate overall economic policy. In a transition, Cuba's national budget will likely be radically overhauled to meet the needs of a new market economy. This includes rationalizing expenditures away from subsidizing state enterprises and determining the economic needs and viability of Cuba's numerous social programs. Effective debt management will be critical to ensuring that Cuba can meet its financing needs and manage the profile of its debt. Its first task will likely be to normalize external debt. It will also need to manage the balance between domestic and external debt. Such a ministry would also need to ensure that proper expenditure controls are in place and procurement rules are followed.

#### **RECOMMENDATION:**

- *The U.S. Government, in conjunction with the IFIs, should offer technical assistance to a Cuban transition government on budgeting, expenditure management, debt management, and procurement rules.*

#### **E. Create an Independent Tax Collection Agency**

During a transition period and the change in the locus of economic activity from the state sector to the private sector, building an effective market-oriented tax system and agency to collect taxes will be necessary to ensure adequate revenue collection and preserve the transition government's ability to set tax policy. Maintaining revenues also will support stabilization during a transition period and ease the need for the new government to obtain financing. It will be critical that the Cuban transition government stress the political neutrality and independence of any taxing authority. As noted earlier, ONAT, Cuba's existing internal revenue agency has been an instrument of state control for those involved in self-employment activities. Tax avoidance, a problem experienced in many Latin American countries, is likely to be a problem in Cuba also, unless Cubans are convinced that a new authority will be truly apolitical.

## **RECOMMENDATION:**

- *The United States and the IFIs should be prepared to offer technical assistance to a free Cuba to help set up the new collection agency.*

### **F. Streamline Existing Government Economic Ministries**

Communist Cuba has never been short of bureaucracy. The Council of Ministers, through its nine-member executive committee, handles the administration of the economy, which is largely state-controlled except for a tiny and shriveling self-employed sector. Fidel Castro is President of the Council of State and Council of Ministers and his brother Raul serves as First Vice President of both bodies as well as Minister of Defense. Immediately below the Council of Ministers there are 30 Central State Administration bodies comprising 27 Ministries and three Institutions.

The transformation of Cuba's present centralized economic policies into those of a competitive market democracy will require major structural changes and technical assistance. One of the early priorities will be the need to reform, reorient, and consolidate existing ministries that deal with non-market economic issues into a structure designed to encourage market development, promote private sector economic growth, and expand trade.

E-government can be a key factor in streamlining and restructuring the various ministries. Visitors to Cuba will undoubtedly find a citizenry starved for information. Clearly, inefficient government and corruption will be some of the challenges faced by a Cuban transition government in the short term. Cuban entrepreneurs will have little idea how to manage an economy and conduct business in the Information Technology (IT) age. A modern, robust, and liberalized telecommunications infrastructure and access to computers are fundamental to the success of any E-initiatives.

Proper use of the Internet and a simple e-government system can simplify procedures for foreign investors and provide for the speedy delivery of important commercial information. Government procurements can be posted on the web, taxes can be collected, utility bills can be paid, and government services information can be maintained and updated, all online. This is a particularly valuable medium as it helps promote the concept of open government. In view of

the closed nature of the Castro regime, this would be an indication that times are genuinely different.

## **RECOMMENDATIONS:**

- *The U.S. Government, if requested, should assist a free Cuba in developing a more rational design for its numerous economic ministries.*
- *The U.S. Government should be prepared to provide assistance to a free Cuba in the area of e-government. In addition, assistance in this area should be sought from countries that have extensive experience in this sector.*
- *The U.S. Government should encourage the World Bank to assist a free Cuba in reforming its public sector through its Governance Reform Program.*
- *U.S. Government institutions such as OPIC and EXIM should be prepared to assist U.S. telecommunications and information technology companies in establishing investments in the sector.*
- *The U.S. Government should be in a position to assist a Cuban transition government in consolidating and/or improving mechanisms among the various ministries. For example, in the United States, the Trade Promotion Coordinating Committee, chaired by the Secretary of Commerce, is used to coordinate promotion activities among the numerous federal entities involved in trade. Mechanisms such as this could be a model for a free Cuba.*
- *The U.S. Government should offer technical assistance for evaluating and eliminating unnecessary regulations that hinder the efforts of private enterprise, thus simplifying procedures. It should also offer assistance in improving the public sector's management and technological skills.*

## **G. Promote Ownership of Private Property**

### **1. Establish Private Property Rights**

The restoration of private property rights will be one of the biggest challenges of the transition period. In particular, as noted above, the challenge of expropriated property, especially residential property, is a Gordian Knot. Many

Cubans left the island under difficult conditions, leaving behind their families, their possessions, and their way of life. Many believed they would return soon, beginning a wait that is now in its forty-fifth year. In the meantime, the Castro regime's Urban Reform Law gave renters property, at least in name, while the subdivision of many homes created overcrowded and substandard living conditions. In addition, a lack of supply and years of deferred maintenance have taken their toll on Cuba's housing stock. The regime has stoked fears that Cubans will immediately lose their homes should Cuban exiles return. Similarly, this has been one of the most difficult issues in Eastern Europe. Somehow, restitution or compensation of property must be balanced with the need to maintain and not exacerbate an already severe housing crisis. Without clear protection of private property, real estate, and investment, sustained economic growth will be difficult to achieve.

At the World Summit on Sustainable Development in Monterrey, the U.S. Government stressed the key link between property rights, market opportunity, and democratic governance. Accessible and transparent property rights systems — comprising laws, institutions, and information systems harmonized with informal practices — are a “hidden” infrastructure often taken for granted or overlooked, yet essential for commerce, services, and governance. As Peruvian economist Hernando de Soto argues, broad-based growth means making the law effective to mobilize the vast assets of smaller firms and of poorer households that constitute this informal economy.

Through this “hidden” infrastructure, governments recognize rights and responsibilities in uses and transactions of property. At the same time, incentives and information are generated that are vital to public and private planning, revenue collection, and service provision, for example, housing, credit, water, energy, and disaster management.

Good governance of property is important for the provision of financial services to micro, small and medium enterprises. Property rights matter both for primary access to credit (securing loans for consumption and enterprise activities) and for capital availability to lending institutions (securitization of loan portfolios/secondary markets participation).

With regard to primary credit supply, pledging of collateral was traditionally a barrier to access to institutional sources of credit for small and informal

businesses. The introduction of microfinance institutions dramatically reduced this barrier. Microenterprise development programs have demonstrated that the immediate need for credit can be answered without collateral and that specialized microfinance institutions are effective in removing other barriers to credit access (e.g., by offering alternative administration mechanisms and risk management techniques).

Still, the limited dollar amount for microfinance loans can be a damper to enterprise development. Graduation to bigger, individual loans at better interest rates is facilitated by collateral. Also, coverage of the still-underserved target population can be expanded through property system reforms that make collateral-based lending viable.

In an interview with the Center for International Private Enterprise, Hernando de Soto noted that:

Clear-cut property rights are indeed essential since you can only pledge collateral if you own something. If you give somebody a valid, respected, secure property title, it's really the first step in the securitization process. Let's take the U.S. example, ...at the bottom of these mechanisms is the fact that somebody who owns land or other private property can pledge it as collateral. This engenders a great deal of the capital markets in the U.S. and even anchors the rest of its financial system.

Today, many donors offer significant support for improving the documentation of property rights and streamlining administrative processes regarding property-based transactions.

The bottom line is that transparent and equitable property markets are a keystone of vibrant market economies, strong democracies and healthy environments. These bring the peace and stability needed for nascent market economies to mature.

## **2. Assistance in Creating a Real Estate Market**

Creating a viable system of institutions and markets that restores consumer confidence in the secure holding and exchange of real estate will be an important

part in Cuba's transition to a free market economy worthy of investment. A major challenge in Cuba will be re-creating a property titling system along with laws, standards, and regulations under which property can be bought, sold, transferred, or foreclosed.

In most market-based economies including the United States, the responsibility and discretion for most of the choices regarding transactions, operation, and maintenance of real estate are left with the private parties most closely associated with the decision. A vast private sector infrastructure of professional service providers generally emerges to meet the need, including real estate developers (who, with architects, general contractors, and builders, construct residential housing as well as commercial office and retail space), appraisers (who help value property), property insurers (who protect against casualty losses), real estate brokers (who help people buy and sell property), lenders (who, supported by a broad financial network, broker the financing), property managers, etc. Each profession normally adopts professional standards and accepted codes of conduct. With the ability to own and exchange real estate, it is reasonable to expect that the professional service sector needed to produce real estate and facilitate its exchange would develop in Cuba, particularly with the assistance of the professional service sector in the United States and non-profit organizations such as the Institute of Real Estate Management and the National Association of Realtors. That process will be accelerated with the standardization and discipline that development of a primary mortgage finance system will impose.

### **3. Establishing a Primary Mortgage Market System**

Establishing a primary mortgage market system in Cuba will be an important part of bringing about broad ownership of private property and the sound basis for a stable and growing economy. A key prerequisite is an institutional framework of credit enhancements and mortgage products that permit households to leverage a modest level of assets to finance most of the purchase price of a home with borrowed funds. In the United States, the principal institutions by which government assists mortgage finance have evolved since 1934 to include the government-operated Federal Housing Administration (FHA) and Ginnie Mae and Federally-chartered Fannie Mae and Freddie Mac, coupled with private mortgage insurance (PMI). Federally insured depository banks and thrifts also play a significant part in providing mortgage finance. However, a viable system for Cuba would not need to be so institutionally complex.

The aforementioned institutions provide either a credit enhancement that links borrowers to funds from lenders in the primary market or a credit enhancement that links lenders to funds from ultimate investors in the secondary market. FHA helps borrowers secure mortgage funds from lenders by providing them a credit enhancement in the form of government-backed mortgage insurance at an actuarially fair premium that protects the lender against default loss up to 100 percent of the unpaid principal balance. Ginnie Mae helps lenders secure loanable funds from the capital market by providing them a credit enhancement in the form of a government guaranty of on-time payment of principle and interest to capital market investors should a lender fail to make the payments. Thus, FHA borrowers utilize FHA insurance in the primary market to secure mortgage funds from lenders who in turn utilize the Ginnie Mae guaranty in the secondary market to obtain the borrowed funds from capital market investors. Thus, a single governmental entity combining the functions of FHA and Ginnie Mae could provide the necessary primary and secondary market credit enhancements. However, such an entity would need to set standards governing lender approval, credit and collateral underwriting standards, minimal property standards, settlement standards/consumer protections for single-family and multifamily finance, respectively.

Would-be owners in need of financing to purchase a home or multifamily structure must assure lenders and ultimately the credit enhancer (mortgage insurers or guarantors) that they not only have the capacity but also sufficient incentive to repay the loan according to schedule, and protect and maintain the security for the loan. Hence, any would-be owner seeking financing must overcome two key obstacles. The first is underwriting with a demonstration of responsible management of past credit situations and a reliable source of income that the lender determines sufficient, after considering other scheduled and normal expenses, to support the loan.

The second hurdle is the accumulation of sufficient cash to pay the equity down payment and transaction costs associated with the property sale and mortgage financing. The equity down payment is in essence an insurance deductible that the borrower must forfeit before a lender or a mortgage insurer would bear any loss. The down payment and accumulation of cash to pay transaction costs not only serve as an incentive for the borrower to act in ways consistent with minimizing the potential for a lender's or insurer's loss, but it also

represents a demonstration of the borrower's capacity to budget and accumulate funds, a skill the owner will need to build in order to cover capital repairs and maintenance of the property.

#### **4. Establish a Secondary Mortgage Market System**

A secondary mortgage market affords two principal advantages. First, it lowers the cost of mortgage finance by allowing credit risk and interest rate risk to be separated and borne by those best able to bear it. Second, it levels the cost of finance by connecting local housing markets to international capital markets so that borrowers have access to the lowest cost funds, not just those available locally. As mentioned above, a credit enhancement for lenders in a secondary mortgage market would provide them a liquid source of funding by permitting lenders and investors to easily sell and buy bundles of mortgage loans without regard for the underlying credit risk. Establishing a secondary mortgage market would require a governmental entity, similar to Ginnie Mae, to underwrite a security instrument backed by mortgage loans and guaranteed against loss from credit risk that could trade in international capital markets. That entity would have to set out, administer, and enforce the terms and conditions under which the guaranteed security instrument could be issued. It would have to establish standards for the guaranty and its pricing, create a process to service and manage the instrument, monitor performance of issuers, provide for recovery of collateral from defaulting issuers, and provide training.

#### **5. Develop a Government Agency to Promote Housing**

Cuba currently has a Ministry of Housing and a Ministry of Construction that built much of the country's public or "social" housing. An assessment of their strengths and weaknesses will help determine how best the U.S. Government can communicate and assist a free Cuba to address the Cuban people's housing needs. This assessment can be done in coordination with similar efforts by other nations such as Spain and Mexico.

#### **RECOMMENDATIONS:**

- *The U.S. Government, through USAID and other donor institutions, should offer to assist a free Cuba in re-establishing the right to own, rent, and sell private property. Particular emphasis should be placed on U.S. experience*

*with homeownership and on promoting the benefits of property rights and ownership.*

- *Given the nascent character of any mortgage market in a newly free Cuba, the U.S. Government could provide advice in establishing a credit-enhancing agency along the lines the FHA initially followed. A Cuban transition government should be offered expertise in underwriting, property valuation, and minimum construction standards.*
- *The U.S. Government should assist a free Cuba in developing primary and secondary mortgage markets based on its vast experience in these areas.*
- *The U.S. Government should be prepared to offer to assist a Cuban transition government to organize itself to address the housing issue and to train Cuban officials in a transition government, including in the promotion of affordable housing by private sector entities, mortgage guarantees for financial institutions, and fair housing protections.*

## **H. Establish Free And Efficient Labor Markets**

According to Human Rights Watch, the Cuban government's virtual monopoly on jobs allows it to exercise tight control over the nation's workforce.<sup>14</sup> To be given a job, a worker in Cuba is asked to sign a contract that includes a pledge of support for the Cuban Communist Party.<sup>15</sup> Such policies and practices prohibit an efficient use of human resources, placing workers in jobs they may not have the skills for or interest in doing. As a transitional Cuban government begins to denationalize state-owned and controlled entities, workers will encounter a new world in which the state will no longer be the provider of the paycheck, allowing for a more productive and efficient free market economy and potentially causing significant worker dislocations.

### **RECOMMENDATIONS:**

- *The U.S. Government has significant experience working with countries that have recently undergone or are undergoing transitions from controlled*

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<sup>14</sup> Human Rights Watch, *Cuba's Repressive Machinery* (1999).

<sup>15</sup> Center for a Free Cuba, *The European Union and Cuba; Solidarity or Complicity* (September 2000).

*economies to market economies. This technical assistance should be offered to a free Cuba to help it establish mechanisms that can ease the transition, helping place workers in new jobs, as well as changing old attitudes about the role of government in providing employment.*

- *The U.S. Government should also offer technical advice to a free Cuba to the extent that a transition may require changing the laws and role of the Labor Ministry to allow the free labor market to function and to improve a free Cuba's compliance with International Labor Organization (ILO) core labor standards.*
- *The U.S. Government should also be prepared to offer its extensive experience helping countries develop their labor market information systems and infrastructure for those systems. For example, in several Caribbean countries, a U.S. Department of Labor project has installed computer software and hardware to support labor market information systems; assisted stakeholders in the development or enhancement of Labor Force Surveys, Occupational Wage Surveys, and Productivity Indicators; and provided direct assistance in sampling and survey design by technical experts.*
- *The U.S. Government should also assist a free Cuba by providing a coordinated process for revising labor laws in order to promote strengthened labor-management relations. This would facilitate private sector development by establishing a sound, equitable, and predictable framework for labor relations; promoting democratic participation of social partners in governance; cultivating transparent and accountable laws; and making legislation more enforceable.*
- *The U.S. Government should also offer extensive technical advice to Cuba in supporting projects that promote healthy labor-management relations, a key element to a healthy and dynamic workforce. In Vietnam, for example, where the industrial relations system is inadequate to support the country's transition towards a market economy, the U.S. Department of Labor has a project to develop workplace democracy and sound industrial relations at the national, provincial, and enterprise levels, including the prevention and settlement of disputes.*

## **I. Promote Healthy Labor Management Relations with Newly Independent Unions**

As stated in Chapter 1, the ILO has been critical of the lack of freedom of association in Cuba, particularly the official union confederation's monopoly on trade unions as institutionalized in the Cuban Labor Code. During 2003, the ILO's supervisory bodies also examined cases related to threats, detentions, and pressure against workers who attempted to form unions outside the established structure. In June 2003, the ILO Conference Committee on the Application of Standards pointedly requested that the Cuban government accept an ILO "direct contacts mission" with a view to ensuring the application of freedom of association in law and practice.

Cuba is clearly in violation of the ILO's 1998 Declaration on Fundamental Principles and Rights at Work, particularly with regard to the right to freedom of association and collective bargaining. These basic principles are essential to promoting an open economy, higher living standards, and a favorable climate for trade and investment. Although Cuba has legally committed itself to upholding these standards by accepting the 1998 ILO Declaration and ratifying core ILO Conventions on fundamental labor rights, clearly many of these basic rights are systematically denied in practice.

Keys to any effort to rebuild and fortify a free labor movement in a post-Castro Cuba would be complete reform of the Labor Ministry's inspection functions and investments in efforts to raise awareness among employers, workers, and government representatives about labor rights. To serve as a vehicle for workplace democracy and to open a national dialogue on labor rights, these efforts should be undertaken in a transparent process involving employers, workers, and government representatives.

### **RECOMMENDATIONS:**

- *The U.S. Government can offer extensive technical advice to a free Cuba in supporting projects that foment healthy labor-management relations, a key element to a dynamic workforce. DOL has experience in other countries running programs to improve labor law, strengthen labor inspection, eliminate forced labor, and reduce commercial sexual exploitation. It has worked*

*primarily through the ILO in these efforts, but it has also involved other international and national organizations with expertise.*

- *The United States can also provide medium- and long-term assistance to a transitional government in Cuba by providing a coordinated process for revising labor laws so that they are consistent with ILO standards and promote strengthened labor-management relations. This would facilitate private sector development by establishing a sound, equitable, and predictable framework for labor relations; promoting democratic participation of social partners in governance; cultivating transparent and accountable laws; and making legislation more enforceable.*
- *A robust program to address labor rights in a free Cuba would include involvement in the following areas:*

### *1. Labor Law Reform*

*Reformed labor laws could facilitate private sector development by establishing a sound, equitable, and predictable framework for collective and individual labor relations, promoting democratic participation, cultivating transparent and accountable laws, and making legislation more accessible.*

*The DOL could work with international experts and partners, such as the ILO, to provide technical advice in the reform effort. Special emphasis would be placed on democratic and participatory approaches in all stages of the discussions with employer and worker organizations and other concerned parties. As a result, the program would promote sustainability by building the capacity to effectively amend, implement, and enforce labor laws.*

### *2. Raising Awareness*

*After four and a half decades of Cuban government repression of any signs of independent labor activity, substantial effort will probably need to be exerted to provide Cuban workers and employers the knowledge and tools to secure full respect for their rights. The DOL could assist a transition government undertake a broad range of activities to develop*

*public awareness of labor issues and train Cuban partners to conduct seminars on current labor laws and available services.*

### 3. Strengthened Inspection Services

*DOL could also provide assistance to help improve the effectiveness of government labor inspection function. The goals would be to create a corps of inspectors trained in modern inspection techniques and to assist in developing a system for monitoring violations. If the transition government agrees, the DOL could provide assistance to*

- *develop policies, training, and procedures for carrying out labor inspections to enforce national laws;*
- *foster strong institutional linkages among government officials, employers, and workers;*
- *implement a program to target inspections to the most problematic employers and sectors;*
- *audit labor inspectorates and develop national plans for labor law compliance;*
- *train staff in the technical knowledge of modern inspection systems; and*
- *create a computerized database for labor inspection reports.*

## **V. ENGAGING AND EMPOWERING THE CUBAN PEOPLE**

The U.S. Government should facilitate the flow of remittances and other private funding flows to Cuba during a transition to help provide the Cuban people with the resources they need not only to survive but also to prosper through the creation of small and medium enterprises.

The Cuban-American community is especially well placed to provide support for Cuban entrepreneurs during the initial transition to democracy and free enterprise. Cuban-American firms should use their in-depth knowledge of the U.S. market to accelerate the establishment of commercial and economic linkages

between the U.S. and Cuba and facilitate the island's reintegration into the world economy.

The United States should provide training to new Cuban entrepreneurs focused on the benefits to be derived from working with a market economy, and in particular the importance of adopting strong rules of law to facilitate the smooth functioning of the market. For the past 45 years, Cuban entrepreneurs have been forced either to flee Cuba or to engage in informal and often "illegal" business activity. The Castro government taxed, harassed, and otherwise impeded self-employment and other market-driven activities.

The United States should encourage Cuba to permit employees of denationalized firms and agricultural cooperatives to purchase shares in these formerly state-owned enterprises.

The United States should extend its trade capacity efforts to a free Cuba, including those geared more directly toward promoting rural development and encouraging export diversification.

The United States should work with a transition government to remove all obstacles to self-employment and other forms of entrepreneurship in a free Cuba. With U.S. Government funding, Cuban-American and other U.S. NGOs and consulting firms can provide training and technical assistance to any Cuban who wants to open a small business.

The Pan American Development Foundation and Junior Achievement International, through USAID funding, are already training business trainers in Cuba. The U.S. Government should greatly expand these and similar efforts during a transition. U.S. Government programs that assist in training mid-level managers in U.S. business practices should be expanded to include Cuban professionals.

## **VI. CONSULTING AND COORDINATING WITH THE INTERNATIONAL COMMUNITY**

### **A. The International Community**

Issues involving privatization, debt, aid, and trade, to name a few, can all benefit from including the international community before, during, and after the transition process. For example, in the area of trade, the United States could encourage the European Union (EU) to finalize a free Cuba's access to the Cotonou Agreement, which would provide preferential access to the EU market for certain Cuban products.

Other transitional economies should be approached to the extent that they may offer valuable lessons to Cuba based on their recent experiences.

The burden of the reconstruction need not fall completely on the shoulders of the United States. Clearly much of the training and education can be provided by international organizations such as the World Bank, the Inter-American Development Bank, and the Organization of American States. Also, there is a huge body of knowledge and inventory of good practices that can be drawn into the process.

Organizations such as *Fundación Chile* can be called upon to share experiences with the newly formed Cuban government and the developing Cuban private sector. Trade associations in the United States and abroad can be called upon to lend technical expertise regarding best practices, research and development, trade generation, and job creation. Specific industry associations can be used to provide information and matchmaking opportunities for specific ventures. State government development agencies can provide business contacts and assist in the formation of investment ventures.

### **B. Some Initial Internal Steps**

In order to be prepared for a transition and to implement programs in the economic arena quickly, it would be prudent to establish a U.S. Government Standing Committee for Economic Reconstruction (SCER), to act in coordination with the Department of State Transition Coordinator (see recommendations in Chapter 1) specifically on economic issues addressed in this report. The SCER

would meet as necessary to review reconstruction plans, ensure that appropriate agencies are prepared to implement programs immediately and to update programs as needs change or as a situation might dictate. This committee should be made up of representatives from Commerce, State, USAID, Justice, SBA, OPIC, EXIM, Agriculture, HUD, USTR, and Treasury. Other agencies can be included as required. This Committee should be chaired at the Deputy Assistant Secretary (DAS) level with participation at the DAS or Office Director level at participating agencies. The Committee should report periodically regarding its reconstruction plans and its readiness to implement the same.

In a similar vein, strong consideration should be given to establishing a standing private sector advisory committee composed of Cuban experts from around the country to ensure that the best available advice is provided to the U.S. Government as it prepares for a free Cuba's transition. As an initial step, this standing committee should review and comment upon this report, ensuring that it becomes a longer term planning document. The committee would then be expected to meet on a regular basis to add more detail to this initial planning.<sup>16</sup>

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<sup>16</sup> Both the SCER and a private sector advisory committee could assist a Cuba Council -- which may be designated under Sec. 203 of the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act -- to ensure coordination with the private sector in responding to a transition in Cuba.