Understanding a Cuban Transition

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The joint announcement by Presidents Raúl Castro and Barack Obama in December 2014—after eighteen months of negotiations—that Cuba and the United States would begin efforts to "normalize" diplomatic relations came as a surprise. It was greeted as a sign that normalization of economic relations was likely to follow and that Cuba's half-century experiment with communism would end in transition to some form of market-oriented mixed economy.

Indeed, beginning around 1990, all of the world's other Communist states except North Korea had transitioned to economic systems that relied to a significant degree on market orientation and a central role for the private sector. The Soviet Union and its central European bloc have disappeared, and China and Vietnam have transitioned to pragmatic forms of socialism that coexist with robust forms of market capitalism. All now have for-profit private corporations that benchmark the performance of state-owned enterprises, stock exchanges, foreign direct investors in stand-alone or joint ventures, as well as portfolio investors in local equities and bonds, and they provide legal protection (though often questionable) for private property.

Cuba now faces the kind of existential crisis that the other Communist counties faced twenty-five years ago: unless it abandons its political ideology, it won't generate sufficient economic growth and prosperity for the system to survive and adapt. The transitions in the former Communist countries have generally been successful, but

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they have taken time and had their ups and downs. But economic liberalization has invariably encouraged political liberalization and demands for key elements of a civil society. This has been most evident in countries such as Poland and Latvia. The process has been more gradual but nevertheless perceptible in China and Vietnam.

Economic transition will force Cuba down the same path, but it will come at a price—political transition that may undo much of the fifty-year legacy of "Fidelismo," which the government, now led by Raúl Castro, is likely to resist. Fidelismo, however, is more than socialism—it also has embraced a passionate desire for independence from the United States.

Cuba's Long Search for Independence

Spanish rule of Cuba was chronically troubled by local unrest among Cuban-born Spaniards, other ethnic Europeans, and a large population of Afro-Cubans who arrived as slaves to work the sugar plantations and were emancipated in the 1880s. The first and the most brutal of Cuba's three wars for independence began in 1868 (the Ten Years War). The cause was taken up by sympathetic Americans who pressured the U.S. government to intervene, but President Ulysses S. Grant refused to do so (Smith 2001, 498–99). The Spanish prevailed but had to suppress a second uprising (the Little War of 1879–80). The third effort, the War of Independence (1895–98) inspired by founding father José Marti, in which the United States intervened on the part of Cuban revolutionaries (the Spanish-American War, 1898), was successful. American involvement broadened the dimensions of the conflict and ended Spanish control of the Philippines and Puerto Rico.

After independence and contrary to Marti's and his followers' hopes, U.S. politics exerted significant influence on Cuban affairs. To justify withdrawing American military forces still occupying Cuba, protect America's substantial commercial interests, and limit Cuba's economic and political relations with foreign powers, Congress passed the Platt Amendment in 1901. In return, Cuban sugar was given preferred access to the U.S. market. Thus, Cuba's independence was never fully achieved; indeed, the United States simply displaced Spain as the overseas power on which Cuba was dependent.

Cuba's domestic political condition from 1901 to 1959 was tumultuous, and the benefits of economic development for ordinary Cubans, especially in the countryside, were well below expectations. American companies operating in Cuba continued to enjoy the watchful attention of powerful U.S. political officials and remained a dominating presence in key sectors of the economy. The Cuban government seemed perpetually bogged down in internal struggles. The U.S. Marine Corps occupied Cuba from 1917 to 1923 to quell continuing disturbances.

In 1933, Fulgencio Batista—an obscure figure of humble origin—led the Revolt of the Sergeants and overthrew the incumbent government. Batista attempted some reforms but relied heavily on the United States for assistance, which further expanded American commercial control of the Cuban economy. Batista's regime was generally associated—certainly by its opponents—with corruption, collusion with organized crime (the Mafia), repression, and an indifference to the social conditions in which the majority of the population lived (Sweig 2009, 1–33). The once hopeful expectation of a pathway from depressed Spanish colony to a vibrant civil society enjoying the fruits of a competitive market economy was hijacked by American business, a dictator, and the mob.

Castro's Revolution

The driving force of Cuba's revolution in 1959 was Fidel Castro. A lifelong political activist, Castro was motivated by factors other than a desire for a Communist utopia. He craved true independence for Cuba, especially from the United States, which, he believed, considered Cuba to be a convenient ally in the evolving Cold War but otherwise an inferior, dysfunctional Caribbean country not worth much attention.

Castro assembled a small band of guerilla fighters in 1956 that challenged Batista's much larger forces in the Eastern Provinces. He became a romantic figure pursuing a quixotic dream that few expected would succeed. But the Cuban army was not loyal to Batista, so many of his soldiers defected. Surprisingly to many Cubans, Castro prevailed. Even then, many expected he, too, would be bought off by the Mafia, which controlled the lucrative gambling industry in Havana. But Castro surprised everyone again by throwing out the mob along with Batista (English 2007, 31–50).

Fidel's political objectives were not well understood in Washington, but his overthrow of U.S. ally Batista and the killing of thousands of his supporters (often by impromptu firing squads) made Castro an unwelcome figure. A few months after ejecting Batista, Castro sought a meeting with President Dwight Eisenhower, which was refused. Soon afterward, the regime nationalized U.S.-controlled businesses in Cuba and welcomed offers of assistance from the Soviet Union—in direct contravention of the Platt Amendment. The Soviet Union soon agreed to purchase almost all of Cuba's exports (including its entire sugar crop) and provide various forms of economic and financial aid. Such assistance was crucial for Cuba's economic survival and represented a golden opportunity for the Soviet Union to step into the enemy's backyard. Castro declared Cuba a Communist state in 1961.

Soviet presence in Cuba triggered alarms in Washington. In early 1961, the Kennedy administration assisted Cuban exiles in a bungled effort to overthrow Castro forces at the Bay of Pigs. The following year Russia's stationing of nuclear missiles in Cuba resulted in the Missile Crisis, the most intense and dangerous moment of the Cold War. Castro's embrace of America's key enemy permanently soured relations between the two countries and resulted in tough unilateral American sanctions (the Embargo) that were aimed at regime change and to this day remain in place. In Cuba, these sanctions are known as “the Blockade.”

Fidelismo

Searching for ideological clarity regarding the revolution’s objectives, Che Guevara, an Argentine and one of the Marxist purists in the Castro circle, wrote *Socialism and the New Man in Cuba* in 1965 (Conroy 2007). The “new man,” he wrote, should be literate, healthy, secure, and economically equal, if never actually prosperous.

In 1968, all private property in Cuba was nationalized, and forty-eight thousand private businesses were eliminated. Little was done to improve Cuba’s already backward economy. Stripped of sectors such as tourism and dependent on state-owned companies for essentials, the economy lost much of its remaining vitality along with most of its investors and entrepreneurs.

Dependence on the essential Soviet lifeline lasted thirty years. The end of the Soviet Union in 1991 caused a severe economic crisis in Cuba. Gross domestic product (GDP) dropped by 35 percent, and foreign trade was down by 70 percent. The Soviet support was gone, and Cuba had to fend for itself—something its inefficient, isolated economy was barely able to do. The result was an acute state of privation that lasted for nearly a decade, which the regime called the “Special Period in Time of Peace.”

Cuba’s foreign-exchange holdings collapsed, making it difficult to import food and other essentials. Assistance and investment were sought from China, Iran, Spain, and the Latin American countries, but without much success. Cuba also began to “hire out” physicians and medical teams to countries willing to pay for them in dollars. Hard times persisted until Hugo Chávez became president of Venezuela in 1999 and entered into an economic alliance with Cuba that reportedly generated about 15 percent of GDP in Cuba (“The Cuban Question” 2004).

Its fragile trade balance and limited sources of foreign exchange led Cuba to create a dual-currency system. Resident Cubans were paid in and spent Cuban pesos under strict rationing of food and other essentials. Nonresidents were required to purchase “convertible currency units” (CUCs) at $1 per CUC, which was then subjected to a 13 percent tax. CUCs were exchangeable for pesos at a fixed ratio (today 1:23). The system sent all foreign exchange and profits from transactions in CUCs to the government. As with any exchange system that tries to supplant market rates, the Cuban system requires elaborate controls and enforcement mechanisms.

The Exile Community

In 1959, many Cuban families that had been economically successful chose to emigrate, mostly to the Miami area. This exodus of Cuba’s businesspeople, property owners, and other professionals has now exceeded approximately 1 million people. Many of these immigrants had relatives who were killed or imprisoned by the Castro regime, and most of their property was confiscated. There are now about 2 million Cuban Americans living in the United States, many quite prosperous compared with the 11 million nearly destitute Cubans living in Cuba.

The Cuban diaspora formed an increasingly powerful opposition to Castro's regime and has used its considerable political influence (and the key role of Florida in U.S. politics) to encourage both exceedingly favorable treatment of new Cuban immigrants to the United States and policies that would continue to pursue regime change in Cuba.

Fidel Steps Down

In 2006, Fidel Castro became ill and "temporarily" transferred his powers to his less flamboyant and more pragmatic brother Raúl. The illness persisted, and in 2008 Fidel, at age eighty-two, stood down, and the National Assembly elected Raúl president. Fidel then ended his commanding role over all aspects of Cuban society.

Fidel's legacy is that Cubans today are universally literate and healthier and have enjoyed a politically stable "time of peace" and a sense of "national dignity" for more than fifty years. Economic inequality is very low, although almost everyone's standard of living is low. Moreover, all this has come at the cost of enormous gaps in Cuban civil society as measured by generally accepted standards of human rights. Even so, there is little sign of public discontent or unrest in Cuba. Dissenters are dealt with harshly, but most people are not dissenters. U.S. policies have encouraged unrest in Cuba, but these policies have not been successful.

The legacy, of course, has some important economic negatives. Fidel allowed Cuba to fall to the ravages of decay, obsolescence, and dysfunction. Whereas Cuba was the third most prosperous economy in Latin America and the Caribbean in 1959, it ranked twenty-second in 2013, with a per capita GDP ranking of ninetieth in the world (U.S. Central Intelligence Agency 2013, 4–6). Per capita comparisons may be less meaningful due to price and exchange controls, but Cuba's level of national income and rate of growth doubtless are far below potential.

Other than sugar, tobacco, nickel, and tourism, the country exports little. Agriculture has been a spectacular failure; the country still imports 70 percent of its food. Further, 85 percent of the country's workforce were employed by the state in 2006. The population is aging, with the birth rate stuck at European levels.

Hans de Salas–del Valle (2011) estimates that Cuba's foreign debt exceeded $72 billion in 2010, including $44 billion of debt owed to Russia and Venezuela but excluding unsatisfied claims by American corporations and citizens. On this basis, Cuba's public-debt-to-GDP ratio (125 percent in 2010) is similar to that of Greece. Cuba's sole source of financial support in recent years has been Venezuela, a country now mired in economic and political problems of its own.

Raúl and the New Cuba

On accession to the presidency and probably earlier, Raúl Castro appeared to recognize that Cuba's economy was truly in perilous condition, though he has not conceded that Fidel's economic model has failed. The Soviet crutch upon which the model initially depended was gone, and its replacement, Venezuela, became questionable after the death of Hugo Chávez in 2013. Raúl appears to have understood that Cuba is on its own and has no choice but to evolve.

Raúl accordingly cut costs in government and state-owned enterprises, reduced reliance on imports, shopped for financial aid and credit, and made a number of deregulatory and liberalizing changes in Cuba's economic administration to promote a more prosperous and sustainable socialism.

The reforms offered incentives to ordinary Cubans to set up small businesses, to lease unused farmland for their own cultivation, and to buy and sell homes and automobiles for the first time. Plans were announced to lay off workers in state-owned enterprises in two waves of 500,000 each, requiring them to seek self-employment in the private sector. The government expects 20 percent of the Cuban workforce to be shifted to the private sector by the end of 2016. To encourage the private sector to find entrepreneurial solutions to production and employment, Raúl had the Communist Party endorse the "311 Points" plan of further deregulation and liberalization (Frank 2013).

The population of small-business entrepreneurs jumped from about 150,000 in 2010 to roughly 600,000 in 2014.[1] *Paladares,* restaurants in private homes (serving mostly the growing tourist flow), proliferated along with beauty parlors, dance studios, repair shops, and a variety of "offer and demand" markets on the streets. For years, Cubans have had to hustle to earn extra money (notably in CUCs) to supplement state-dictated salaries however they could, though in 2015 some state salaries paid to doctors and other professionals were doubled. Raúl's reforms have made the investment process easier and involved less risk of trouble with the authorities. Importantly, after the reforms, hard currency and in-kind inflows from Cuban Americans doubled to about $3.5 billion in 2013, especially in investments in residential renovation and small enterprises that otherwise would have been unaffordable (Havana Consulting Group 2015).

Nevertheless, virtually all of the new growth in the private sector has been at the small-business level. And the small-business sector continues to struggle with other obstacles.

There is no viable market for financial credit except what the government provides to state-owned enterprises. Residents pay household bills in cash after queuing up outside a bank branch and then queuing up again inside the branch. There are no

1. According to an estimate provided to us by Juan A. Triana, a Cuban economist studying growth in the private sector.

credit cards and few checking accounts. Buildings silently deteriorate from lack of maintenance. Housing shortages persist, with families sharing apartments in a living situation reminiscent of the Soviet experience. With the exception of a few trunk roads, intercity transportation is minimal, and Internet services are far below most developing-country standards—though important (if still imprecise) Internet reforms were announced in March 2015. Even with 35 percent of the workforce now allocated to the private sector, Cuba's economy has a long way to go to meet minimal standards of most emerging market countries.

Raúl's modest efforts to open the Cuban economy have been very welcome in Cuba, despite the difficulties that invariably accompany such changes. Even with the reforms, however, Cuba's economy grew only 1.4 percent in 2014, although the average growth rate for the prior five years was 2.3 percent (Economist Intelligence Unit 2015). The economy may weaken further if Venezuelan aid is reduced. So the announcement of improved relations with the United States in December 2014 has met with general enthusiasm and, no doubt, rising expectations among Cubans.

In January 2015, three Cuban academic economists active in the "updating" of the economy and its transition reported that Raúl and his inner circle were cautious about making changes that might risk Cuba's socialist model being displaced by one that was "excessively capitalistic."[2] Raúl evidently fears the adverse effects of a market-based economy, such as the shadowy underside of the post-Soviet transition in Russia, and the wide-open embrace of market capitalism in China. These economists favor a more rapid program of modernizing the economy and are frustrated by the old guard's reluctance, yet even they agree that Cuba must not jeopardize its landmark achievement of universal income equality even at the cost of lower economic performance to retain it.

Raúl's economic advisers are accordingly examining transition experiences elsewhere and have at least a preliminary interest in Vietnam, although the two countries are very different. Vietnam's transition started in 1989, and the government has given up less economic control to the private sector while still improving growth and prosperity.

Toward Normalization

The announcement to normalize relations suggests that both sides threw in the towel. The United States concedes that a half-century's economic isolation of Cuba hasn't worked in changing the regime and moving Cuba to U.S. standards of civil society. The Cubans appear to recognize that in order for their form of socialism to survive, Cuba will have to accept some aspects of market economics.

2. The meeting took place between the Cuban academic economists and us in Havana.

The gains from normalization, however, are not symmetrical. Cuba has much more to gain economically from normalization than does the United States, so much of the burden of concessions needed to achieve it is in the Cuban camp. The normalization process is now in the public domain, so both sides will be under pressure to speed things up.

But not everything has to be resolved quickly. Though the two parties may be bogged down in concerns about the U.S. trade embargo, human rights, the return of the U.S. base at Guantanamo, and reparations for private property seized in 1959, progress can be made when and where possible since diplomatic relations have now been reestablished, with partial benefits received from resolving each issue increasing the appetite for resolving the rest.

U.S. Initiatives

U.S. sanctions are anchored in a series of laws that established, fortified, and extended economic measures against Cuba. These laws, together called "the Embargo," are tightly drafted to deny Cuba relationships with the United States (LeoGrande 2015).[3]

The Embargo prevents all U.S. exports of goods and services to Cuba except food and medicine and denies imports from Cuba (Frank 2015). It applies to all U.S. corporations and their foreign subsidiaries, and its various terms and provisions are to be maintained until the Cuban government "moves toward democratization and greater respect for human rights" and "unless and until certain claims, including for seizure of properties, against the Cuban government are met." These sanctions can be changed only by future acts of Congress.

No doubt the Embargo has imposed enormous costs on the Cuban economy over the decades, but it has not caused the regime to collapse. With the Castros gone (or almost gone), and Cuba no longer a threat to U.S. national security, some argue, it is time to end the Embargo to let market forces do the job of regime change. Others, however, argue that Cuban socialism is still oppressive and that to remove the Embargo only rewards and entrenches the regime.

Normalization therefore depends on whether the present or subsequent U.S. administrations can secure the votes in Congress for repeal or amendment of the existing statutes. Those on the right have held out for total regime change, whereas those on the left have insisted on major concessions on democracy and human rights. Meanwhile, Cuba, fiercely determined to retain its independence and assert equality in negotiations, is unlikely to concede much on either of these key points.

3. The main U.S. laws that compose the Embargo include the Cuba Democracy Act of 1992; the Cuba Liberty and Solidarity Act of 1996 (Helms–Burton); the Trade Sanctions, Reform, and Export Enhancement Act of 2000; and a number of other laws that require U.S. actions to destabilize Cuban society, encourage defections and immigration to the United States, and limit travel and the applicability of patents and trademarks.

Beyond the Embargo, however, there are other obstacles to overcome in normalizing the relationship.

State Sponsors of Terrorism

Cuba used to be included on the U.S. State Department's list of State Sponsors of Terrorism, a designation applied to countries that have repeatedly provided support for acts of international terrorism. The countries on the list in December 2014 besides Cuba were Sudan, Iran, and Syria. Presence on the list prohibited U.S. and non-U.S. banks and other financial institutions from engaging in activities in or with Cuba. Cuba no longer appears to be aiding terrorism, so President Obama approved the removal of the designation in April 2015. Restrictions on Cuban financial transactions are still in force under the Embargo, however.

Property Claims

The U.S. Foreign Claims Settlement Commission has ratified about six thousand property claims by U.S. corporations and citizens, which, with accrued interest, are worth about $7 billion, plus similar claims worth several billion dollars from as many as two hundred thousand Cuban exiles who became U.S. citizens. Cuba, on its side, has asserted counterclaims of $180 billion in damages created by the U.S. Embargo and various damages due to destabilization and harassment programs sponsored by the Central Intelligence Agency and other U.S. agencies for many years. The United States is almost certain to reject these claims out of hand (LeoGrande 2015). Nevertheless, there is some room for rough justice as part of a solution, just as eastern European claims settlements were agreed upon in the years following World War II and later claims on Swiss banks were settled. Claims for property seized in East Germany by Nazis or Communists could be filed after German reunification in 1990.

The Cuban Adjustment Act

The Cuban Adjustment Act of 1966 provides special immigration status for Cubans reaching U.S. territory, where they are freely admitted as asylum seekers fleeing a country that is hostile to the United States and to which they cannot return without fear of punishment. Many thousands of Cubans have taken advantage of the especially low barrier to entry into the United States. Most recently, the flow of Cuban migrants has joined migrants from South and Central America via Mexico across the southern U.S. border and receive preferred status on arrival under the act. Cubans say, however, that the law is no longer necessary because they can travel freely to the United States and back. Cuba also maintains that the law drains ambitious workers and entrepreneurs away from Cuba, where they are sorely needed. If Cuba is no longer considered hostile to the United States, the rule is unnecessary and should be scrapped. But the law is popular in the Cuban American community, and its repeal could set off a migration wave (already begun) by those seeking to get to the United States while they can.

Guantanamo

The United States established the Guantanamo naval base after the Spanish-American War, and it now operates under a "perpetual" lease agreement signed in 1934 that Cuba considers a violation of its sovereignty. Cuba wants the base returned to its control and the United States to leave. The U.S. government has not indicated any willingness to surrender its lease.

Reconciling U.S. Law and Reality

Much of the support for the Embargo originates in Miami, where the Cuban American opposition to the Castro regime remains strong. This opposition is apparently eroding, however, as original emigrants age and liberalized travel rules have resulted in much improved contacts between Cubans and Cuban Americans, including some inward investments. Otherwise uninvolved Americans are increasingly visiting Cuba under eased "people to people" travel rules and have shown increased sympathy for improving Cuban relations.

Political pressures brought by business and other communities eager to trade and invest in Cuba are also increasing as competition from non-U.S. companies not subject to the Embargo builds up. Important among those applying such pressure are American food producers and the hotel, tourism, and telecommunications industries. Food sales for cash only are permitted under the Embargo (for humanitarian reasons), but in 2014 they totaled only $291 million, less than half the $710 million made in 2008 (Frank 2015).

Failing full repeal, the Embargo might be amended piecemeal, based on progress in diplomatic negotiations and evidence of economic liberalization. Some further liberalization may also occur under presidential executive orders, though the Embargo does not leave much room for this approach.

Cuban Initiatives

Recognizing that negotiations aimed at repealing the Embargo—on which Cuba has long blamed its weak economic performance—will take considerable time, Cuba may be able to accelerate the process by giving tangible indications of good faith.

The Cuban government agreed to release fifty-three political prisoners as part of the announcement made in December 2014; since then, Cuban detentions for political purposes reportedly have declined (Gordon 2015). This decline might be taken as a sign of improvement in human rights if it is sustained. Many members of Congress believe they must see such signs of improvement to justify support for repeal or amendment of the Embargo.

Cuba may also agree to some form of international mediation of claims and counterclaims. Such an effort would take years to complete and may not result in much in the way of actual financial reparations, but it may be another sign of good faith to move negotiations ahead.

Beyond such political actions—and regardless of their outcome—Cuba needs to reform and rebuild its broken economy. Even if it continues to be restricted from trading with the United States, it is still free to trade with the rest of the world. It needs reforms to be able to do this.

Foreign Direct Investment

Since 1995, Cuba's official policy has been to welcome foreign direct investment (FDI). It claims to provide a reasonable set of protections and mechanisms to encourage foreign investment, but in practice the climate has been very unwelcoming (Feinberg 2012).

Almost all FDI in Cuba is subject to arbitrary case-by-case government approval, lengthy delays in securing the approvals, the requirement that the foreign investor have a sizeable Cuban partner (which so far have invariably been state-owned enterprises), as well as delays and frustrations in putting the investment to work. Even without these impediments, the investment would still have to produce a satisfactory return in a relatively small, low-growth economy with limited consumer purchasing power and virtually nonexistent credit. So foreign investors, with plenty of more attractive opportunities around the world, have put Cuba near the bottom of their lists.

The World Bank provides data for Cuba from 1990 to 2008. The average value for foreign investment in Cuba was a trivial 0.02 percent of GDP with a minimum of −0.03 percent in 2000 and a maximum of 0.11 percent in 2007. By contrast, Costa Rica—a nearby market economy with a GDP about the same as Cuba's (but a population less than half Cuba's)—has averaged FDI of about 4 percent of GDP since 1990 and more than 6 percent in recent years (World Bank 2015).

In March 2014, the National Assembly passed a new FDI law that lowers income taxes significantly for joint-venture investments and delays the application of taxes for several years. This is a step in the right direction but has been met with skepticism by Cuban-based diplomats and others who doubt that the country has truly had a change of heart and wants to attract large-scale corporate investments.

In support of the new law, the Cuban foreign-trade and investment minister said that the country needed to attract from $2 billion to $2.5 billion per year in new FDI to meet its economic growth target of 7 percent per year. The law was passed, but the investments did not occur, nor was the (unrealistically high) growth target achieved. But the minister was right—without foreign capital and know-how Cuba's backward economy is unlikely to change much by itself (Trotta 2014).

A good place to begin attracting foreign investment is in the Mariel deep-water port project, a joint endeavor with the Brazilian government, from which $800 million of financing was received in 2009. The project is still under construction. Cuba has awarded the contract for operating the port to a Singaporean company, and hundreds of proposed foreign investments related to the port are awaiting approval. In the long run, a lifting of the Embargo and the completion of the expansion of the Panama Canal will buoy the project, but the Mariel facility will still have to be competitive for transshipments with other Caribbean ports. For that to happen, Cuba needs to approve as many of the FDI proposals for Mariel as it can.

The tourism sector offers another good FDI opportunity. The Cuban buzz has reportedly attracted many more tourists than before, with around 3 million arrivals in 2014, worth approximately $2.7 billion. But most of the hotels to put them up in are government-run, dilapidated old things without much space or appeal. It would be both smart and easy to sell or lease the old hotels to European or Latin American hotel companies to rehabilitate and operate and to catch the Airbnb wave—it would be an immediate boon for Cuban families to rent spare rooms in their homes for valuable CUCs.

Letting foreign agribusinesses into Cuba is another important opportunity. Though many Caribbean nations are unable to feed themselves, Cuba is by far the largest island in the Caribbean, with plenty of underutilized arable land, some of which could viably be brought into production at world prices. Not only should Cuba be able to produce its own food (and thus save considerable, scarce foreign exchange), but it also ought to be able to produce ample surpluses to export.

For years, Cuba has blamed its lack of economic progress on the Embargo, but there is no embargo with the rest of the world. The more Cuba moves to encourage FDI among the rest of world, the more U.S. companies will pressure Congress to lift the embargo.

Until now, the Cuban government has been stuck in a legacy of mistrust of everything not in conformity with the Cuban socialist model. Now it needs to decide what activities it wants to attract and start negotiating terms and conditions. This is an easy place to begin once policy direction is agreed.

Modernizing the Financial System

Cuba needs to put high priority on modernizing its outdated financial system, in terms of both operational capacity and infrastructure. Banks need to provide retail checking accounts and credit facilities (including credit cards, which now may be useable in the CUC sector) on a much larger scale and to establish financial markets.

Plenty of developing countries have achieved these goals. Cuba has a golden opportunity to start from scratch and learn from others along the way.

Underlying any financial system is an infrastructure of institutions that provide a necessary base of rules and know-how so that transactions can occur safely and reliably. These institutions begin with a legal system that protects savers and investors from fraud and abuse; an accounting system that assures that financial reporting is accurate, timely, and reliable; and a regulatory system that can enforce the rules, and encourage the formation of exchanges, insurance markets, pension funds, and other institutional investors. It can take years to establish this basic infrastructure, so the sooner Cuba starts down this path, the better.

Also, there is the need to address Cuba's dual-currency system, which Raúl has promised to abolish as part of his reform effort. He has not yet done so, though, probably because it is still a useful way to capture foreign exchange. Allowing more FDI and liberalizing manufacturing and agribusiness can generate much more foreign exchange than CUCs ever will, but, of course, these changes, too, will take time. CUCs can be phased out as these other programs are phased in, but the monetary value of the CUCs needs to reflect market conditions and will have to be devalued.

Joining the International Monetary Fund

Cuba is one of very few countries that are not members of the World Bank and the International Monetary Fund (IMF). It withdrew from the IMF in 1964. However, the Embargo requires the United States to vote its 17 percent interest in the IMF against Cuba's entry into the IMF and the World Bank, a vote that requires 85 percent of members' consent. So the United States can by itself block Cuba's admission.

Cuba has not applied to become a member of the IMF. To the extent that it now seeks economic reform, it would gain much assistance from the IMF in modernizing its financial system as well as development aid and advice from the World Bank. Until the United States is ready to repeal or amend the Embargo and to vote for Cuban membership in the IMF, Cuba may be able to work out an arrangement to benefit from advice and assistance from the IMF on improving its financial system if it indicates an intention to join when the United States allows it to do so.

Improve Its Credit Rating

Cuba currently has a bond rating of Caa2 from Moody's, after a downgrade in 2014 because of the deteriorating financial position of its sponsor, Venezuela (now rated even lower, at Caa3). This very low "junk" rating is of little use to Cuba, which in any case has not tried to access international capital markets. However, Moody's has signaled that if Cuba persists with institutional reforms that enable stronger economic growth, and the transition to a more market-oriented economy is credible, it may raise the rating.

A higher rating would enable Cuba to tap the international capital markets for a limited amount of longer-term debt financing that would accelerate its reform and economic development efforts. Access to international capital markets would also provide Cuba with the opportunity to repay some of the debt it has to other countries and avoid default. As an indicator, Vietnam's Standard & Poor's rating is BB−, and Costa Rica's is BB.

Privatization

Technically, all property in Cuba is owned by the state. Restoring property to the private sector has been an important task of all transition economies. Former Communist countries have dealt with the issue in different ways, but all have found it helpful to privatize state-owned assets through several ways: sale of shares in large state-owned-enterprises through initial public offerings, sale of certain midsize enterprises through the global merger and acquisition market, and sales or leases of shops and other small businesses directly to workers or groups of individuals.

Cuba can do all of these things, but it will have to decide what properties are to be sold—a decision that has to consider the political sensitivities of particular enterprises to the country as well as the economic viability of the enterprises being sold. It must also consider which (or what portion) of these assets may be sold to foreigners and the relative importance of price against the value of having economic assets returned to "market control."

An easy first step would be to allow employees of small businesses to acquire the businesses from the government, perhaps with funding provided by government loans. Another would be to allow foreign investors to acquire a minority interest in large economic properties (banks, mining, airlines, port facilities, and tourism assets). Such purchases would provide governments with valuable foreign exchange at the beginning of the transition period and put the assets on a private-sector footing (even if the government does not adopt private-sector practices in full), and the foreign partner would bring management know-how, technology, and finance to improve companies' operations. All of this could be done through private sales initially, with subsequent sales waiting for the development of securities markets.

Conclusion

By now, even the most ardent boosters of the Cuban experiment in socialism must concede that the country's postrevolution economic performance has been an epic failure. Imposition of a Stalinist command economy and wholesale replacement of civil society (even after its adaptation in a distinctive "Cuban" context) have inevitably worked against the fundamentals of human nature by precluding the benefit of market signals in production and consumption, savings and investment, and efficient deployment of human resources. In Cuba, the result has been chronic economic underperformance over six decades and the nagging suspicion that the revolution's basic social goals could have been achieved much more cheaply and effectively by working *with* the market instead of *against* it.

Cuba's present economic situation is in part the result of a fifty-year feud between it and the United States over obsolete Cold War issues. But times change. The political leadership on both sides must recognize that each will be better off if they settle their various disputes and return relations to normal. There are substantial political obstacles on both sides, but these obstacles have been set aside to begin a normalization process. How long the process will take is anyone's guess.

Cuba has the most to gain from returning its economy to a market footing. The transition can be started with a series of small steps—small steps can be successful—but they will lead to demands to liberalize larger, wholesale sectors of the economy and for political concessions. The larger liberalization and political concessions will ultimately weaken the authoritarian regime's hold and threaten its continuation. The alternative—doing too little—is hard to gauge but may end up in protests and confrontation. Either way, as Cuba's economy deteriorates further and age takes its toll on the Castro brothers, major changes for the country almost certainly lie ahead.

Political tensions after Raúl steps down (he says he will retire in 2018) may end up in an interim military takeover of the government. At best, however, Raúl could leave a legacy of a successful transition, backed by savvy, entrepreneurial Cuban Americans, to a thriving, Singapore-like "entrêpot" market economy prospering from its proximity to the United States and the growing economies of Latin America.

Cuba certainly should prefer this outcome, and the United States should, too. Both should recognize that liberalization of Cuba is not a zero-sum game and that today's current events may be shown in the future to have been a crucial inflection point for the economic revival of the Caribbean and North American regions.

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