The Old Men of C(uba): Will the Sun Also Rise (on Cuba)?

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Cuba is approaching a crossroads regarding the future of its economic system. The paper begins with an overview of Cuba's vital statistics and then discusses the country's changing political landscape that has already triggered some selected -- albeit very modest -- changes. We review the long history of foreign country involvement in Cuba's affairs in order to put the tortured relations with the United States into sharper focus. Part 3 describes the methodological framework used to highlight Cuba's major weaknesses, and we conclude that the distortions that have been compounded over fifty years can be unwound only by introducing a comprehensive reform program that embraces new leadership and new thinking.

INTRODUCTION

Stabilizing the global economy from the impact of the financial and economic meltdown which was triggered in the fall of 2008 and that caused the worst economic recession in the United States since the Great Depression in the 1930s, along with developing and implementing regulatory reforms in the financial sector to reduce the risk of recurrence, in addition to adopting policies to lower the nearly double-digit US unemployment rate have all rightly over-shadowed many other important developments that have recently taken place in the Western hemisphere. For example, since the turn of the century, with the exception of Colombia and (until very recently) Mexico and Chile, most of the countries in Latin America have voted in left-of-center, populist governments.

With regard to Latin America, a favorable international economic environment until 2008 along with more responsible economic policies and/or improvements in the legal and tax environments for business in some countries, i.e., Brazil and Chile (and most recently in Peru), resulted in higher economic growth rates and improved living standards. In fact, " the five years to 2008 were Latin America's best since the 1960s, with economic growth averaging 5.5% per year and inflation generally in single digits" (Reid, 2010). In other countries such as Argentina, Bolivia, Ecuador, and, of course Venezuela, ideologically left and populist policies have raised political tensions and have triggered discontent among large swaths of the population. While these policies may have contributed to short-term gains for some segments of the population, they have introduced some deep-rooted distortions into the economy which are unfavorable for long-term growth, and that are likely to impair the improvement in future living standards. The most obvious example of this is Venezuela where, throughout the last decade, annual inflation, every year, has been in double digits, and net foreign direct investment has been negligible, and even negative in three out of the last four years (United Nations, 2009).

Another important development that occurred in the Western hemisphere was the announcement in July 2006 by Fidel Castro, in office since 1959, to temporarily step aside as president of Cuba because of illness. His brother, Raúl, replaced him on an interim basis and in early 2008 the change was made permanent. Needless to say, this development provides both opportunities and challenges for the people of Cuba, as old age and infirmity "bring down the curtain" on the Castro brothers and their aging associates.

Will Cuba continue down the populist, Socialist path charted during the Cold War of the 1960s, sustained by continuing dollops of financial and political support from Venezuela's Hugo Chávez, which replaced the long-term aid provided by the Soviet Union that collapsed in the 1990s? Or will Cuba adopt a market economy such as Brazil and Chile, requiring liberalized political institutions and fundamental political reforms to improve human rights and guarantee political freedoms unknown in Cuba since the 1950s? This, of course, would mean an end to the monopoly of political power by the ruling Partido Comunista de Cuba (PCC).

Perhaps, as some observers have suggested, Cuba will choose a middle-way by opting for a China-like (or Vietnam-like) model that is characterized by continued liberalization toward a market economy but without the critical political reforms that would encourage Western-type political institutions and personal freedoms.

Before speculating on the road that will ultimately be chosen by Cubans over the next decade, this paper assesses the current state of the Cuban economy, identifies some of the major weaknesses that will need to be addressed, and highlights some of the opportunities that Cuba can seize as the Castro era comes to an end. To be sure, throughout the paper, the policies of the United States towards the Cuban government are highlighted because of the critical and central role Cuba's behemoth northern neighbor plays in influencing Cuba's economic growth (or stagnation) and living standards.

Part 1 begins with an overview of Cuba's vital statistics that provide some measures of the island nation's relative material wellbeing as compared with some of its regional neighbors. In addition, we review the current -- domestic and international -- political landscape that influences the performance of the Cuban economy, as well as some of the major economic and political events of the last few years that may have served as a catalyst for the modest reforms already introduced by Raúl Castro since he assumed his position in 2006.

Part 2 provides a short summary of the history of US involvement in Cuba since Fidel Castro became prime minister in February 1959, emphasizing the tortured relations between the two countries since the Cuban Revolution at the height of the Cold War, the tougher measures implemented by the Bush administration, and the recent overtures announced by the Obama administration since taking office a little more than two years ago.

Part 3 provides a review of some recent research regarding some of the "ingredients" judged to be important for a well-performing national economy that is participating in the wider global economy in the second decade of the 21st century. These "ingredients" are used in the next section to assess the current state of the Cuban economy. We conclude by enumerating some of the strengths that Cuba can draw on as it begins a program of serious economic reform and adhesion to the global economy that will require a fundamental break with its current economic model if the country is to improve the performance of its economy and increase living standards for all segments of the population.

PART 1. VITAL STATISTICS, THE POLITICAL LANDSCAPE, AND RECENT ECONOMIC AND POLITICAL HIGHLIGHTS

Cuba, an island nation between the Caribbean Sea and the Atlantic Ocean -- 150km south of Key West, Florida -- is located in the tropics, approximately 21-23 degrees north of the equator. The country has a total area of around 11,000 sq km, slightly smaller than the US state of Pennsylvania. The island stretches about 800 km from the northwest to the southeast, and it is the largest island in the Caribbean. In

2009, Cuba's population was about 11.5 million people, its population growth rate was estimated at 0.23% per annum (p.a.) -- well below the Latin America average of 1.6% p.a.-- and the country continues to experience annual net **out** migration of approximately 30,000 people, some legal and some illegal. At this time there are two ways for Cuban migrants to gain US residency: by obtaining one of the 20,000 visas issued annually for Cubans by the US authorities, or by applying for refugee status after arriving in the US (by whatever means). Cuba has a Diaspora estimated at 1.5m people (The Economist, 2008a).

Life expectancy was reported at 77.5 years and Cuban infant mortality rates are below those in the US (DePalma, 2007). More than three-quarters of Cubans live in urban areas. The country's ethnic breakdown is 65% white, 25% mulatto and mestizo, and 10% black. Cuba boasts near universal literacy for those 15 and older; 94% of Cuban children complete high school, a higher percentage than in the US (Cohen, 2008); and, in 2007, the country spent more than 14% of its GDP on education (EIU, 2008).

It is important to note at the outset that "the quality of the information on countries such as Cuba is so poor that analysis often seems more of an art than a science" (Financial Times, 2008). For example, with the price system so distorted because of controls (including access to foreign currency), there is a very large discrepancy between the estimated 2009 nominal level of Gross Domestic Product (GDP) and the GDP on a purchasing power parity (ppp) basis: \$56.68bn versus \$110.86bn, respectively, and estimated 2009 nominal GDP per capita was approximately \$5,000 while GDP per capita (ppp) was estimated at approximately \$9,898 (using 2009 US dollars) (EIU, 2010).

With respect to the composition of GDP, in 2008 agriculture accounted for 4.5% of GDP (but employed 18% of the approximately 5.2m people in the labor force); industry for 23% of GDP; and services for approximately 73% of GDP. Official unemployment was only 1.8%, but this rate is surely artificially suppressed because of political considerations, as we shall see below. Gross fixed investment as a percentage of 2008 GDP was reported at only 11.6%, well below the rate that would be consistent for increased growth in future living standards. It is important to recall that in 1959 Cuba had the third highest GDP per capita in Latin America and was one of the five leading countries in Latin America in socio-economic indicators (The Wall Street Journal, 2008; The Wall Street Journal, 2010; The Economist, 2008a). Today, fifty years on, Cuba is outranked in the United Nations Human Development Index by democracies such as Argentina, Chile, Costa Rica, and Uruguay, and basic foods such as milk, sugar, and eggs, and basic services such as electricity are rationed, and mundane necessities such as soap and toilet paper are luxuries (O'Grady, 2010). According to one recent report on Cuba, "life is not improving in Cuba, and the quality and quantity of material well being is declining" (Frank, 2009b).

The Political Landscape

Since July 2006 public soul-searching for Cuba's future direction has been acknowledged at the highest political level. After temporarily assuming the presidency when Fidel Castro stepped aside due to illness, Raúl Castro called for an "open debate" on the country's economic policies, and one year later he acknowledged that not everything is right, that is, structural and conceptual changes are needed, specifically citing the inefficiency of the farm sector, low public sector salaries of around \$20 US per month (O'Grady, 2007), and wide-spread inefficiencies and corruption at state-controlled companies (DePalma, 2008). The Financial Times reported," Cuba has an inefficient domestic model due to its extreme centralization and waste, where a dysfunctional bureaucracy resistant to change has prospered" (Frank, 2009b).

In August 2010, while being interviewed by Jeffrey Goldberg of the Atlantic Monthly, Fidel Castro conceded that Cuba's economic model no longer worked (Dombey, 2010), providing, in effect, a "green light" for Raúl Castro to reform the economy. Within a week of this admission, Raúl Castro announced that 20% of the state labor force – about 1 million people – will lose their jobs or be transferred to the private sector over the next five years. In 2011 alone, 500,000 workers from the state payroll are to be shifted to the private sector (Frank, 2010a). It is important to note the significance of this important reform: at the end of 2009 about 4.4 million people – or 85% of the labor force – worked for the state. The official statement regarding this change was: "Cuba cannot continue to be the only country in the world where one can live without working", a veritable "Garden of Eden" (Malkin, 2010).

While it is difficult to discern the extent of the turmoil these pronouncements are causing to the political leadership in Cuba, it is worth noting that the congress of the Partido Comunista de Cuba that last convened in 1997 -- which, in theory, exercises control over government policy -- and that had planned to meet in late 2009 was again postponed, and is now expected to meet in late April 2011 (Associated Press, 2010).

Conditions in Cuba have always been strongly influenced by other countries, most notably by the US, Russia (or more precisely the former Soviet Union), and more recently by Venezuela and China. We discuss the influence of Russia and Venezuela on Cuba in this part of the paper, defer a discussion of the strained relations between the US and Cuba to Part 2, and the expanding role of China in the Cuban economy is discussed in Part 4.

A Brief Review of 20th Century Foreign Involvement in Cuba (and Vice Versa)

Cuba was under Spanish rule from 1492 almost without interruption until the conclusion of the Spanish-American War in 1898. The war was preceded by more than 60 years of protest and civil unrest in favor of independence, following the successes for independence by many countries on the South American mainland earlier in the century. Many Cubans favored annexation by the United States as early as the turn of the 19th century, which was supported by the US government. In 1823, US president James Monroe delivered his eponymous "Monroe Doctrine", warning European countries to leave "America for the Americans". The disturbances in 1898 were sufficiently threatening to the Americans then residing in Cuba for the US government to dispatch the USS Maine to Havana Harbor. After a mysterious accident sank the Maine, with the loss of 268 sailors, an official report issued after the investigation of the explosion blamed Spain, which led to a declaration of war.

The Spanish-American War lasted 10 weeks and ended with the Treaty of Paris, signed in late 1898, that recognized Cuban independence, though the Cubans did not participate in the peace talks and did not sign the treaty that gave the United States temporary control over Cuba, and other Spanish possessions such as Puerto Rico and the Philippines. Less than a year after the passage of the Platt Amendment in 1901, Cuba gained (partial) independence since there were contingencies written into the Amendment that permitted the US to intervene militarily in the island's affairs (along with a perpetual lease of the Guantanamo Bay Naval Base). It is worth noting that a more serious inquiry into the nature and the cause of the sinking of the Maine that was undertaken by Admiral Hyman Rickover in 1974 concluded that the accident was the result of an internal explosion and not an act of war by Spain.

During the first decades of the 20th century there were a series of coups until 1940 when Fulgencio Batista was democratically elected as president. His administration included several members of the Communist party that established numerous pro-union policies and implemented major social reforms. In the 1930s-40s the flow into Cuba of American investments in sugar, tobacco, and mining assets as well as an influx of Mafia mobsters fueled an economic boom which increased living standards for all segments of society and created a prosperous middle class in most urban areas but also widened the gap between the rich and the poor. According to the International Labor Organization, the average industrial salary in Cuba was the world's 8th highest in 1958. Agricultural wages were higher than in West Germany or France, and even though a third of the population still lived in poverty, Cuba was one of the most developed countries in Latin America (The Economist, 2009a).

Former-president Batista, running a distant third as a candidate in the 1952 presidential elections, staged a coup after he concluded that he had little chance of winning the election. In 1953, Fidel Castro, a young lawyer from a rich family, led an armed -- though failed -- revolt to depose Batista, losing 60 companions in a daring attack on a military barracks. In the wake of the failed revolt Mr. Castro was jailed for 19 months, and after receiving an amnesty decamped to Mexico to regroup.

A US-imposed arms embargo in 1958 weakened the Batista government as it fought an armed resistance movement led by Fidel Castro. The successes of Castro's resistance movement culminated in Batista fleeing the country and Fidel Castro becoming prime minister in February 1959, a post he continued to hold for half a century. It is important to note that when Castro attempted to arrange a general strike in 1958, he did not have the support of the Communists or the labor unions (Lewis, 2005).

Castro exhibited a deep hatred of the United States because of its historical involvement in Cuban affairs, and especially for its support of the Batista dictatorship, and, as a result, Cuban relations with the US deteriorated quickly as he embraced the Soviet Union. (Please see Part 2 below for a more detailed overview of Cuban-American relations in the second half of the 20th century). In October 1960 the Castro government confiscated all of Cuba's large businesses, all opposition newspapers were closed down, and all radio and television stations were placed under state control, triggering the first wave of Cuban émigrés. The failure of the CIA-sponsored Bay of Pigs invasion in April 1961 by 1500 Cuban exiles strengthened his ties to the Soviet Union at a time that was arguably the height of the Cold War. After defeating the exiles, Mr. Castro consolidated his power, arresting, imprisoning, and executing thousands of political opponents and former supporters. In addition, hundreds of thousands left Cuba as exiles.

For the next two decades Mr. Castro supported guerilla movements throughout Latin America including Argentina, Venezuela, Guatemala, Paraguay, Colombia, Honduras, Haiti, El Salvador, Nicaragua, and Uruguay. In addition, Cuban intelligence officials established close ties with the Irish Republican Army, the Basque ETA, and the Palestine Liberation Organization. Cuba also supported 17 liberation movements or leftist governments on the African continent including Angola, Ethiopia, Guinea-Bissau, Mozambique, the FLN in Algeria against France, and the Congo.

Needless to say those activities were anathema to the United States, spawning a half-century of tortured relations between the two countries. Arguably, the greatest shock to Cuba's increasingly centralized economy in more than two decades of Soviet support came when Mikhail Gorbachev came to power, that eventually led to the 1991 implosion of the Soviet Union and the collapse of Soviet military and economic support, resulting in a drop in Cuba's economic output of at least 35% from 1989-93 (De Córdoba, 2008).

Relations with the Soviet Union

As early as September 1959 the Soviet Intelligence Agency, the KGB, was operating in Cuba, and the Soviet Union saw the new revolutionary government in Cuba as a valuable asset both in promoting Soviet interests in the Southern Hemisphere and in waging its "cold war" against the United States. In the aftermath of the Bay of Pigs invasion in April 1961, Cuba turned to the Soviet Union for military protection and trade. The Soviet attempt to install nuclear missiles in Cuba ended with an agreement with the US in 1962 that brought the crisis to a conclusion and also assured Cuba's protection from military attack by the United States. In 1972, Cuba became a full-fledged member of the then Soviet trading bloc (the Council for Mutual Economic Assistance (CMEA)), further increasing US-Cuban tensions.

With the dissolution of the Soviet Union and the CMEA in 1991 along with the loss of Soviet economic and political support, the resulting economic emergency forced the Cuban government to abandon its traditional five-year plans and triggered the adoption of a set of reforms that included an effort to secure new sources of hard currency, a suspension of all state investment that did not generate hard currency receipts, limited agricultural reform to reduce Cuba's dependence on food imports and encourage domestic output, drastic cuts in oil and electricity use, an opening to direct foreign investment in joint ventures, the development of the tourism sector, and the legalization (until October 2004) of the use of the US dollar. This period was known as the "special period in peace time" that ended in February 2008.

One unwelcome by-product of the new policies introduced during this interval -- and, in particular, of the legal use of the US dollar -- was a large increase in income-inequality that undermined one of the mainstays of the Cuban Revolution of a half-a-century ago. The legal use of US dollars spawned special stores that were reserved for "dollar only" purchases with no official exchange rate. (This issue is discussed in more detail in Part 4, below).

The Role of Venezuela in Cuba

With the dissolution of the Soviet Union, its "empire", and its associated "clubs", e.g., CMEA, at the beginning of the 1990s, and the advent of the "special period in peace time" because of the loss of Soviet economic support, Cuba benefited from the ascent of Hugo Chávez to the Venezuelan presidency in early

1999. It would not be an exaggeration to say that the limited and short-lived reforms implemented during this "special period" were reversed with the arrival of Hugo Chávez and his deep pockets, and that the Venezuelan support that followed boosted Cuban economic growth (The Economist, 2008b).

Chávez made no secret that his "spiritual leader" was Fidel Castro as he began to transform Venezuela with his self-proclaimed "Bolivarian Revolution". By using ongoing legislative and constitutional maneuverings, Chávez continues to centralize power, reign in individual freedoms, and subject the economy to distortions that result from years of populist policies. Simultaneously, Cuba has forged close ties with Venezuela in order to replace the lost Soviet aid. In return for subsidized Venezuelan oil of up to 100 thousand barrels per day worth as much as $6bn a year in cash payments, Cuba has sent sports trainers, political organizers, and more than 20,000 doctors, dentists, and other medical personnel to Venezuela to improve Venezuelans' access to health care (De Córdoba, 2008; Caldwell, 2008). Venezuela has also announced plans to build a liquefied natural gas plant in Cubato, a petrochemical plant in Cienfuegos, and is financing an oil refinery in Santiago after Cuba's announcement of estimated offshore oil reserves of 20m barrels (Romero, 2008). In addition Cuba has tight ties with Venezuela's military and intelligence systems with an estimated 500 Cuban military advisors in Venezuela being used to further strengthen Chávez's grip on power.

PART 2. US-CUBAN RELATIONS SINCE THE CUBAN REVOLUTION

As was mentioned above because of Fidel Castro's deep hatred of the United States relations between the two countries quickly deteriorated as Castro consolidated his power after becoming prime minister in February 1959. The failed CIA-sponsored Bay of Pigs invasion by Cuban exiles strained relations with the US to the breaking point. With Cold War tensions at their highest level at that time, the Soviet Union was willing and able to support Cuba politically, militarily, and economically. The "end-game" of the Soviet attempt to install nuclear weapons in Cuba resulted in an agreement between the US and the Soviets that assured Cuba's future as a Soviet ally in the US's backyard.

Diplomatic relations between the US and Cuba have been severed since 1961, and Cuba was expelled from the Organization of American States in 1962 as a result of US financial pressure on the organization. Also in 1962, the US declared a trade embargo against Cuba, which lasts to this day with certain qualifications that are discussed below. In addition, the US imposed a travel ban on US citizens wishing to travel to Cuba. It is important to note that the US trade embargo is enshrined in Federal law, with only limited modifications permitted at the discretion of the President's executive orders.

Interests sections were established in 1977 in each other's capitals but efforts towards a normalization of relations have repeatedly failed because of irreconcilable differences over issues related to Cuba's ongoing support for third-world revolutionary movements (see Part 1, above), the special status accorded Cuban exiles in the US, and the continuing US control of the Guantanamo naval base in Cuba. Since the fall of the Soviet empire the US has focused its displeasure with Cuba less on the national security threat that Cuba poses to the US mainland and more on the political and economic shortcomings in Cuba. The politically influential anti-Castro lobby in the US has, for the most part, prevailed over the years to maintain the economic sanctions that were imposed on Cuba almost half a century ago.

In 1996, the Cuban Liberty and Democratic Solidarity Act (also known as the Helms-Burton Act), the governing statute that dictates US policy on Cuba, extended the trade embargo against Cuba to include foreign companies and individuals, and refuses them entry into the US if they are doing business with Cuba. It is of interest to cite some of the main features of this Act. The law prohibits the President from lifting trade restrictions until Cuba legalizes political activity, makes a commitment to free and fair elections, and as long as Fidel and Raúl Castro remain in office (Steinberg and Wilkenson, 2010). In the aftermath of the 9/11 terrorist attacks, tightened US banking regulations also increased the impediments to those contemplating doing business in Cuba (The Economist, 2008c).

Conflicting US Interests: Cuban Émigrés vs. the US Business Community

US policy toward Cuba has been carefully guided -- some would say governed -- by hard-line émigrés from Cuba, and as these émigrés age polls indicate that an increasing majority of Cuban-Americans favor a dialogue with Cuba (The Economist, 2007a; De Córdoba and Luhnow, 2008). In fact Barack Obama promised he would move toward normalizing relations with Cuba if Cuba made some improvements on human rights issues. Though he received only 35% of the total Cuban-American vote in Florida in 2008, he captured a majority of that group's 18-29-age cohort (Perez, 2008). Furthermore, by early 2009, the Cuban-American National Foundation -- the leading organization for Cuban exiles -- called on President Obama to expand relations with the Cuban people (Cave, 2009).

In stark contrast to the hard-core early émigrés from Cuba are some segments of the US business community who are eager, for obvious reasons, to see an end to the trade embargo imposed on Cuba. They include agricultural and food exporters, and companies in the airline, telecoms, and tourism sectors, and the oil industry that would like to drill for oil in Cuban waters. A 2001 report prepared by the US International Trade Commission, which favors US business interests, estimated that the US trade embargo against Cuba cost US businesses up to \$1.2bn a year in lost sales (Dombey, 2009a). In fact, since 2000, US companies have been able to sell food and agricultural products to Cuba to non-governmental entities for cash. By 2009, the US exported \$710m of food products to Cuba (Levine, 2009), and by mid-2010 the US was already Cuba's fifth largest trade partner (Financial Times, 2010).

The Bush Administration tightened the long-standing ban on travel and imposed more onerous restrictions on remittances to Cuba from the US. Though the Bush Administration maintained the agricultural waiver, travel to Cuba was severely curtailed from the approximately 80,000 American tourists in 2000 to just a trickle by the end of 2007 (McKinley, 2007). Family visits were restricted to once every three years and remittances sent from the US were capped at \$300 per quarter for the receiving household, though both of these sanctions were reversed early in 2009 -- and again extended in January 2011 -- by the Obama administration (Schmitt and Cave, 2009; Thompson, 2011). It is important to point out the importance of remittances from the US to Cuba: In 2005, remittances from the US accounted for 80% of Cuba's total remittances, which comprised about 50% of Cuba's total foreign currency receipts (Millman, 2009). Furthermore, the Cuban government extracts 20% of the value of the dollar remittances in addition to imposing large price mark-ups when these dollars are used in the hard currency shops (Frank, 2009a).

There are other measures that the US president can take without approval from Congress but the administration is unlikely to move towards normalizing relations with Cuba until there are palpable moves towards democratic reform in Cuba such as the release of political prisoners and introducing freedom of the press (Stolberg and Barrionuevo, 2009; Dombey, 2009b). Ironically, the state of human rights in Cuba appears to have worsened since the arrival of the Obama administration in January 2009. For example, the death of Orlando Zapata, who starved himself to death in February 2010, makes it difficult for the US to move forward with Cuba. It appears that only after the meeting of the long-delayed Communist Party congress -- now due to convene in late April 2011 -- can we expect to see any serious moves by Cuba to address US concerns that would enable the US to begin normalizing relations with Cuba.

PART 3. THE METHODOLOGICAL FRAMEWORK

Before discussing the areas in which reform will be needed to improve the long-term performance of the Cuban economy to the end of raising living standards, it is worthwhile reviewing some of the alternative "paths to prosperity" that have been proposed by the leading development experts -- individuals and institutions -- over the last half century.

The ideas of Raúl Prebisch (1959) and Hans Singer (1964) provided the intellectual firepower for the development blueprint anchored in "import substitution" because their thesis was based on the declining terms of trade for primary products and the dynamic benefits to the economy of a vibrant manufacturing sector. These concepts became operational policy in most of South America in the 1960s-70s, ensuring a large and growing role of the state in the economy through supportive taxes and subsidies if not direct ownership of productive capacity.

The role of state involvement in the economy for development purposes that is a corollary of the Prebisch-Singer thesis was actually the foundation of the work proposed earlier by Paul Rosenstein-Rodan (1943) and P.C. Mahalanobis (1955), which stressed increasing returns to scale and kick-starting growth through large-scale investments, and accelerating economic development by government encouragement of heavy industry, respectively.

These “inward” winds of economic development shifted in favor of more “outward” and “market-oriented” strategies that were advanced during the 1970s by Balassa (1971), Bhagwati (1978), Krueger (1978), and Little, Scitovsky, and Scott (1970). The “market-based” approach to improving the performance of the economy and to enhancing living standards reached its zenith with the views of a group of Latin American economists and policymakers, the World Bank (1991), and various academic and “think tank” development experts such as John Williamson (1994) with the so called “Washington Consensus” of the 1990s.

For example, in its 1991 World Development Report, the World Bank articulated four broad requirements that characterize a national economy as "battle ready" to meet the challenges of the fiercely competitive world economy. They included:

A. A stable macro-economy characterized by both fiscal and external balance and low and stable inflation;
B. the adoption of a competitive micro-economy that includes a substantial reduction in state ownership and management of productive assets and the elimination of price distorting subsidies and taxes;
C. strong global linkages that include adherence to GATT (now the WTO), low and uniform tariff rates, absence of non-tariff barriers, a uniform and market-determined exchange rate, a liberalization of the rules governing capital flows and direct foreign investment, and;
D. an active government policy that promotes social and economic investment, especially in the areas of education, infrastructure, and health.

In its 1997 World Development Report (World Bank, 1997), the Bank expanded the reach of the fourth requirement to include the promotion and enforcement of property rights, reducing the level of corruption in the country, and ensuring a reliable legal system -- some of the so-called “second tier” reforms.

The “Washington Consensus” (WC), which was originally compiled in 1990 and published by John Williamson (1994), enumerated a list of desirable conditions that, if adopted and adhered to, would, over time, put reforming countries on the path to success in the global economy. (Please see Table 1, below, for a list of its main points). Since the late 1990s, because of its alleged failure to address the issue of poverty reduction directly, the Washington Consensus was subjected to heated intellectual debate within academia and the major international organizations such as the World Bank (Beattie, 2000). Nevertheless, this framework continued to assume a central role in the debate on development strategies for low- and middle-income developing countries during the first decade of the 21st century. (Readers interested in this debate are referred to (Rodrik, 2010) for an up-to-date review of this subject).

In light of the experience of the late 1990s (increasing poverty rates and stalled economic growth due to an adverse external environment), proponents of the Washington Consensus amended the original framework to ensure that fiscal policy is counter-cyclical to support economic growth in an economic downturn, and to focus on reducing income inequality by ensuring that the poor have access to assets, i.e., education, land titling, micro-credit and land reform, that will enable them to work themselves out of poverty (Williamson, 2003).

TABLE 1
MODIFIED "WASHINGTON CONSENSUS"

A. Fiscal and monetary discipline
B. Redirection of public expenditure priorities towards health, education, and infrastructure
C. Tax reform and improved tax administration
D. Unified and competitive exchange rates
E. Modernization of government and "quasi" government institutions
F. Deregulation
G. Trade liberalization and regional integration
H. Privatization
I. Elimination of barriers to direct foreign investment
J. Banking reform and financial liberalization

While the “reform decade” of the 1990s did restore growth in GDP and GDP per capita in Latin America when compared with the “lost decade” of the 1980s -- growth in GDP and GDP per capita from 1991-98 was 3.5% and 1.7% p.a., respectively compared with 1.0% and -1.0% p.a. in the 1980s (United Nations, 1998) -- many observers of Latin America contended that the “neo-liberal” reforms of the 1990s have not only “failed to deliver sustained growth, but have made the region more vulnerable and increased unemployment, poverty and inequality. As a result of all this, some political pundits assert that Latin America is sinking back into populism and/or anti-market leftist nationalism” (The Economist, 2003). At the end of 2010, this last statement is borne out for most countries in Latin America, particularly for Argentina, Bolivia, Ecuador, and Venezuela.

In a recent review article of economic development blueprints, Dani Rodrik (2010) reviews the experience of China, which over the last three decades arguably has had the most successful growth and poverty reduction program in recorded history, and notes that there does not appear to be any single orthodox Western economic plan that was adhered to by Chinese economists and policymakers. Rodrik also observes that even in (now prosperous) Chile -- which was recently admitted to the Paris-based club of “rich” countries, the Organization of Economic Cooperation and Development (OECD) -- during the 1970s-80s a strict universally scripted development plan was abandoned and a more heterodox (and indigenously articulated) strategy was adopted even during the tense Pinochet era.

It now appears, according to Rodrik, that a more fruitful approach to prescribing a successful path to economic growth and development is one that is based on “diagnostics’, as proposed recently by Hausmann, Rodrik, and Velasco (2008) and Hausmann, Klinger, and Wagner (2008). In place of a “boiler plate” set of rules and a rigid, unyielding approach to growth these development economists propose to identify a country’s binding constraints and then prioritize the policy reforms given the political and social realities of the country involved. These authors argue that the earlier, carefully scripted paths to growth and development have not lived up to their expectations:

> “The currently prevailing view, as reflected in the World Bank’s (2005) report on the lessons from the 1990s or by the blue-ribbon Commission on Growth and Development (2008), accepts the importance of outward orientation but places much less emphasis on trade liberalization and is much more willing to condone a measure of industrial promotion in order to achieve and sustain high growth” (Rodrik, 2010; p. 40).

Rodrik praises China’s so-far successful development approach of grafting a market system on top of a heavily regulated state sector (that was the orthodoxy of an abandoned Communist economic system) with China’s development plan evolving over time as their binding constraints change: first in agriculture; then in industry; then in foreign trade; and eventually in finance, the environment, and pension reform.

It is important to note that despite its impressive poverty reduction cum economic growth program now in its fourth decade, China enjoys enormous leverage in the world because of its population of 1.4bn people -- almost 20% of the world's population -- that is increasingly willing and able to become "21st century consumers". China's voracious appetite for fuel and nonfuel minerals (Sohn, 2008a; Sohn, 2008b), "first world" foods and diets, electricity and other infrastructure goods, along with its abundant and still relatively inexpensive labor force provides it with enormous "monopoly-like" and "monopsony-like" power on world resource, factor, and product markets. For example, China's policy regarding "local content" requirements for equipment used in the production of wind energy, the "Notice 1204" directive, is certain to be in violation of World Trading Organizations rules. The directive has since been revoked, but not before its major objectives were achieved (Bradsher, 2010). The market access that it provides for the goods and services of global companies confers on China tremendous leverage regarding the terms it dictates for foreign (inward and outward) investment, the aid programs it operates, its foreign exchange and capital account regimes, and, above all, its (lightly criticized and) stunted state of political and human rights best exemplified by the official treatment of Chinese dissident Liu Xiaobo, the 2010 recipient of the Nobel Peace Prize.

To be sure, particularly in the wake of the 2008-9 global financial crisis and the need for substantial global rebalancing, China's trade, savings, investment, capital account, and exchange rate policies are exacerbating the adjustments that are needed and increasing the political and diplomatic tensions in the world. The jury is still out as to whether China's one-party political system can be maintained in light of ongoing globalization and technological change.

In the next section which takes the measure of the Cuban economy we continue to rely heavily on the "ingredients" prescribed in the market-based and outward-looking approach to economic growth and development noted in the above-mentioned World Bank reports, while at the same time being mindful to incorporate the contributions made by those advocating a more tailored approach to development that identifies binding national constraints and priorities in the quest for economic modernization over the next two decades. Given the size and importance of the Cuban economy in the world, it is doubtful that Cuba will be able to apply similar leverage on issues such as maintaining a closed capital account, or enjoy an exchange rate regime of its choosing, and so on, as was the case for China.

PART 4. THE ROAD TO REFORM: THE STATE OF THE CUBAN ECONOMY

Macroeconomic Stability

With a view toward improving the performance of the Cuban economy during the next decade it is useful to take the measure of the current state of the economy following the World's Bank "recipe" articulated in the early 1990s and described in Part 3, above. The first of the four broad requirements needed for a well performing national economy is macro economic stability, generally characterized by both fiscal and external balance, low and stable inflation, and high levels of employment.

Before examining the above macroeconomic variables over the last five years it would be of interest to note how the Cuban economy actually performed over the time frame, that is, actual GDP growth from 2005-9. According to the data reported by the United Nations (2009) and the Economist Intelligence Unit (2010), real GDP growth slowed dramatically over the 2005-9 interval. (Please see Table 2, below). The double digit growth rates reported for 2005-06 are no doubt due to the booming world economy, and in particular the strong demand for industrial metals in Asia, that resulted in the run-up in the price of nickel -- Cuba's main export in terms of revenues -- over this interval. GDP growth began slowing in 2007 with the onset of the US and global slowdown, and growth continued to slow in the 2008-9 period as sluggish global growth continued in the aftermath of the financial sector problems in the US and the EU, and the "knock-on" effects of the disastrous 2008 hurricanes negatively impacted growth in the Cuban economy during these years.

Examining some of the GDP components in more detail reveals some of the problems. Reported Gross Investment as a percentage of GDP stands out in particular. Cuba's investment ratio is consistently the lowest in the list of 22 countries in the Latin America and Caribbean region reported by the United Nations (2009). (Please Table 2, above, and Table A-4 in (United Nations, 2009)).

The ratios, which normally range from 17% - 23% of GDP for the region, in Cuba are often reported as one-third to one-half of the regional averages throughout the first decade of the 21st century. (Please see Table A-4 of (United Nations, 2009)). These ratios suggest an economy that is hardly expanding its capital stock, and may even be depleting it after adjusting for normal depreciation of capital. The ratios over the decade certainly attest to the unwillingness (and/or inability) of the international business community to operate in Cuba because of the poor legal, tax, and regulatory framework. Needless to say, Table A-10 of (United Nations, 2009), which reports the region's net foreign direct investment, country by country, for 2000-09, omits Cuba entirely. On the other hand, the meager investment ratios also underscore the inability (and/or unwillingness) of the Cuban State to allocate resources for the purposes of economic modernization that would lead to higher future economic growth and enhanced living standards.

TABLE 2
RECENT MACROECONOMIC DATA: CUBA AND LATIN AMERICA, 2005-2009

Macroeconomic Variable		2005	2006	2007	2008	2009	
Gross Domestic Product (annual % change)							
	Cuba	11.2	12.1	7.3	4.1	1.0	
	Latin America and the Caribbean	5.0	5.8	5.8	4.1	-1.8	
Gross Fixed Capital Formation (% of GDP)							
	Cuba	6.7	8.6	8.2	8.5	-16.0	A
	Latin America	18.5	19.7	20.9	21.9	20.3	
Central Government Balance (% of GDP)							
	Cuba	-4.6	-3.2	-3.2	-6.7	-4.8	A
	Latin America	-1.1	0.1	0.3	-0.8	-2.8	
Consumer Prices (annual % change)							
	Cuba	3.7	5.7	10.6	-0.1	-1.7	
	Latin America	6.1	5.0	6.5	8.2	4.5	
Trade Deficit [A] (US$ bn)							
	Cuba	-5.24	-6.33	-6.39	-10.6	-6.52	
Urban Unemployment Rate (average annual %)							
	Cuba	1.9	1.9	1.8	1.6	1.7	A
	Latin America	9.1	8.6	7.9	7.4	8.3	
Employment Rate[B] (average annual rate)							
	Cuba	70.7	70.7	72.4	73.6	NA	

[A] These data are from EIU (2010)
[B] Employed population as a percentage of working age population
Sources: United Nations (2009); EIU (2010)

With respect to Cuba's fiscal balances during the five years ending in 2009, Cuba was one of only two countries -- Honduras was the other -- in the United Nations' list of 20 Latin American countries that recorded annual public sector deficits on <u>both</u> a "primary balance" and "overall balance" basis for <u>all</u> five years. (It is worthwhile to mention that Cuba's annual deficits, as a percentage of GDP, were much higher than those reported for Honduras (United Nations, 2009; Table A-22)). According to the Economist

Intelligence Unit (2010), since 2005, annual Cuban public sector deficits as a percentage of GDP have ranged between 3.2% and 6.7%. The large 2008 and 2009 deficits, 6.7% and 4.8% of GDP, respectively, can be explained, in part, by the need to finance increased food imports (and maintain the heavily subsidized food prices) in the wake of the above-mentioned weather-related agricultural sector failures in 2008.

Turning to annual variations in consumer prices, inflation in Cuba has been more moderate but at the same time more volatile than annual inflation in the region as a whole as reported by the United Nations (2009). For example, in the decade ending in 2009, Cuba experienced negative inflation in four of the 10 years versus none for the region as a whole, while Cuba's annual inflation rate exceeded the region's average in only three years out of ten (United Nations, 2009; Table A-21). It would be reasonable to assume that Cuba's inflation rate -- both its magnitude and volatility -- is heavily influenced by political considerations given the centralized price system administered by the State. However, with a view toward the future, a reduction in the volatility of inflation is a necessary condition to encourage increased private sector investment to enhance growth prospects and private sector employment.

According to the Economist Intelligence Unit (2010), Cuba's annual trade deficits from 2005-09 have ranged from 12% - 19% of GDP, which highlights the critical role filled by remittances as a substitute for insufficient foreign investment capital to finance the chronic trade deficits despite the substantial credits extended to Cuba by both Venezuela and China in one form or another (Frank, 2010c). In recent years Cuba has been importing about 80% of its annual food requirements and, despite having abundant land, the growing food deficit certainly attests to the need to remove the deep distortions in agricultural and land-use policy that beg for reform even after allowing for the large crop losses and damage resulting from the powerful hurricanes that struck the island in 2008.

On the export side of the trade account, the 2008-09 world financial and economic crisis hit Cuba hard as the price of Cuba's leading export, nickel, declined dramatically as a result of the economic recession. The revenues from Cuban nickel exports make-up 40 - 60% of total export revenues, depending on international nickel prices. This underscores the vulnerability of Cuba's hard currency earnings to the volatility of world economic activity levels in general, and commodity prices in particular. Hard currency earnings from increased tourism have also helped to mitigate the chronic trade deficits but this source of hard currency is also very sensitive to economic conditions, especially in the rich, developed world. Reported tourist visits to Cuba increased from 340,000 in 1990 to 2.3m in 2005 (Smith, 2008).

With regard to the various employment measures reported by the United Nations, unsurprisingly, Cuba's participation and employment rates for the 2000-09 intervals are consistently the highest in the region, and Cuba's urban unemployment rates, over the same time period, are, not unexpectedly, the lowest in the region. (Please see Tables A-15, A-16, and A-17 of (United Nations, 2009)). In the wake of the announcement in September 2010 by President Raúl Castro regarding the intention of the State to reduce public sector employment by 1 million people over the next five years, the Cuban employment measures are likely to begin resembling the more conventional rates characteristic of the region as a whole. Needless to say, the extent to which displaced public sector employees are absorbed into the private sector -- that would maintain the high employment ratios -- will no doubt depend on creating the appropriate legal, tax, regulatory, economic, and financial environment to attract private sector investment, from both domestic and foreign sources.

The Adoption of a Competitive Micro-Economic Environment

According to the World Bank (1991), improving the micro-economic foundation of the national economy includes, among other things, a substantial reduction in state ownership and management of productive assets, and the elimination of price distorting subsidies and taxes.

To better understand how and to what degree the micro-economic substructure of Cuba's economy became so disconnected from the most basic concepts that underpin a modern economic system -- maximizing national well-being by the efficient use of nation's stock of resources -- requires a look back at the promises made at the inception of the Cuban revolution by Fidel Castro in 1959: By signing on to his revolution Cubans would be guaranteed jobs, food, education, and health care, and heavily subsidized housing and transport. But 50 years on the reality of life in Cuba is somewhat different: 85% of the labor force (or 4.4m people) are employed in an increasingly dysfunctional and change-resistant public sector receiving an average monthly wage of US $20; there is an array of strict rationing of the most basic necessities of life including rice, eggs, chicken, fish, beans, sugar, soap, and tooth paste (The Economist, 2009b); there are serious and growing shortages in public transport; two or three generations of Cuban families are living in the same cramped apartment, there is an acute housing shortage of at least 500,000 units (Smith, 2008); and power shortages have led to the introduction of rationing of air-conditioning to five hours a day (The Economist, 2009b). In 2009, estimates indicate that 20% of the population is impoverished and 50% have been left behind (Frank, 2009c). Even Cuba's much-touted health care sector has not been spared: medicines are in short supply, and hospital patients must provide their own syringes, towels, and bed sheets (Stephens, 2010).

Needless to say, given the strict rations imposed on basic goods and services, in conjunction with the low average monthly wage, black markets, corruption, and bribes are flourishing, and everyone seems to have a "night job" to supplement salaries provided by State "day jobs". For example, the use of the Internet is restricted to government offices, so government workers rent out nighttime access for a fee (The Economist, 2008a).

Until recently, it was illegal to own a computer, a DVD player, a microwave oven, and even more basic appliances such as a toaster. Now that purchases of these appliances are legal, it is not clear where the money will come from to buy these products. Remittances from abroad of between US$ 500 million – US $1 billion a year make up some of the shortfall (The Economist, 2007a).

Given the above circumstances of daily life for the average Cuban citizen, official announcements to begin reforming the system that spawned these surreal distortions resulting in unnecessary hardships inflicted on the average Cuban citizen for more than half a century should be greeted by universal approval. But Cubans know better, and are suspicious of the very modest micro-economic reforms introduced to date since Fidel Castro stepped aside as president.

Raúl Castro, with a view toward providing incentives to increase domestic food output (which meets only about 20% of domestic food consumption), is gradually raising milk and meat prices paid to farmers and will provide more freedom for farmers to enable them to control their decisions on farm inputs, outputs, and land-use. That is, the government now recognizes that there is a great need to decentralize decision-making in the farm sector to raise agricultural productivity by reducing the role of the State in all matters of agricultural and land-use policy. By 2009 farmers were permitted to lease fallowed State land and buy their own tools -- such as shovels and boots -- but farmers complain that the State still has a monopoly over most of the critical farm inputs -- such as fertilizers and pesticides -- and agricultural distribution networks.

The official announcement, made in September 2010, that 20% of the State labor force -- about 1 million employees -- would be removed from the State's payroll over the next five years and transferred to the private sector, if actually implemented, virtually ensures that a major liberalization of the country's large retail sector that was nationalized in 1968 -- barber shops, cafeterias, bakeries, car repair services, restaurants, beauty parlors, etc. -- is the next stage in reducing the role of the State in the economy. It goes without saying that both the prices charged for the goods and services in this sector, along with the salaries and rents paid, will have to be market-based.

Shedding 20% of State employees, if realized, is, to be sure, the biggest step toward liberalizing the economy. The consequences of this policy are daunting for the "Cuban system": a likely short-term increase in unemployment, and growing wage (and income) inequality between the State and private sectors on the one hand, and the growing and stagnant sectors, on the other. Also, the success or failure of this major policy shift will depend heavily on the mix of incentives/disincentives that is finally adopted: tax rates, regulations, access to, and cost of, credit, and, over the longer term, on establishing an appropriate system of property rights to facilitate the purchase and sale of assets in order to encourage long-term investment (De Córdoba and Casey, 2010).

In addition to a gradual phase-out of subsidies on food, education, health care, housing, and transport, public sector wages too will have to increase, and so will taxes across the spectrum -- on income, sales, property, and to pay for social security.

Many critics of Cuba are still not convinced that the very modest reforms introduced by Raúl Castro so far are based entirely on conviction, rather than on expediency. That is, the reforms introduced to date are not really intended to address the deep-rooted inconsistencies in the Cuban economy, but rather, to take some of the pressure off the dire state of the public finances. Consequently, some see similarities between these reforms and some of the changes that were introduced, but later reversed, by Fidel Castro during the "special period" of austerity in the mid-1990s in response to the collapse of the Soviet Union and the elimination of the decades of automatic financial supports that accompanied the Cuban-Soviet alliance. From 1989-93, the Cuban economy contracted by 35%, and that led to the introduction of a package of reforms that included encouraging mass tourism, and opening up foreign investment in hotels, mining, telecoms, and oil exploration.

In addition, the government permitted farmers' markets to operate in order to supplement official rations, licensed (small scale) family businesses such as restaurants, legalized the use of the US dollar, and gave State companies more latitude to manage their businesses. However, once the largesse provided by Venezuela was in place, many of the changes introduced in the "special period" were reversed. For example, many of the licenses for small businesses were withdrawn, and other businesses were either regulated or taxed to death (Frank, 2010b).

Only time will tell if Cuba's so far modest reforms announced to date -- and their gradual implementation -- will trigger a real break with the past and lead to a dismantling of the State's iron grip on the economy or whether these announced reforms are being used to extract concessions from the international community.

Global Linkages

Adhesion of the national economy to the larger global economy is becoming indispensible to improving a nation's material well being. It is without doubt that the successful development model implemented by China over the last three decades is, in part, due to China's re-engagement with the world economy after decades of economic autarky. Consumers benefit from liberalized trade by having more choice of goods, often at lower prices and/or with higher quality. More competition faced by domestic producers from imported goods reduces domestic producers' pricing power, and provides crucial incentives to enhance efficiency and productivity. The prospects of higher exports (in part to pay for increased imports) raise both national employment and income.

Liberalization of the capital account, provided the domestic banking system is sufficiently strong, along with a unitary and market-based exchange rate, can confer benefits to both borrowers and investors alike. Lower interest rates for borrowers, and improved risk/reward tradeoffs for investors, as well as greater discipline on the public finances imposed by these open capital markets complement the benefits provided by a liberalized trade account. It is important to note that policy experts are still debating the cost/benefit calculus for developing countries of full capital account liberalization in light of the Asian financial crisis at the end of the 1990s and the financial meltdown in the US and Europe a decade later (Beattie, 2011).

Finally, providing a "state-of-the-art" legal, tax, and regulatory environment for foreign investment is critical for attracting and maintaining much-needed financial capital, new technology, and managerial talent for the national economy. For example, as a part of the new austerity measures instituted by the Cuban government in response to the need to conserve scarce hard currency to pay for food imports, many foreign business partners in Cuba were waiting months for permission to transfer abroad hundreds of millions of dollars in profits from joint ventures (The Economist, 2009c).

Because of the continuing poisoned US-Cuban relations, Cuban membership in regional organizations is limited to those organizations not subject to a US veto. For example, Cuba was expelled from the Organization of American States (OAS) in 1962, and will not be permitted to be rejoin it until Cuba satisfies the demands of the US -- which provides 60% of OAS funding -- that include permitting multi-party elections and allowing a free press (De Córdoba and Luhnow, 2009; Thompson, 2009). Cuba is similarly excluded from membership in the Inter-American Development Bank, and from (the now dormant) negotiations on the Free Trade of the Americas (FTAA) initiative. Cuba is not a member of the World Bank or of the International Monetary Fund but is a member of all the agencies of the United Nations, including the World Trade Organization. In addition, unsurprisingly, Cuba participates in the fledgling organization spearheaded by Venezuelan president, Hugo Chávez, the Alternativa Bolivariana para las Americas (ALBA) that is designed to be a counter-point to the US-sponsored FTAA.

With the recent removal of the ban on purchasing electronic goods such as television, cell phones, and DVDs, and on owning more modest household appliances such as microwave ovens and toasters, Cuba will need considerably more foreign exchange to pay for these imports. Consequently, Cuba has aggressively been looking for ways to attract foreign investment that will help increase hard currency receipts. These ventures include a partnership with Sherritt International, a Canadian mining company, to develop nickel and oil assets, and the Spanish hotel operator, Sol Melia, has opened a number of properties (Cohen, 2008).

The obstacles to attracting foreign investment are formidable: on the one hand, the Cuban government is trying to attract foreign companies without abandoning the “socialist model”, and has been providing trade and investment preferences to key allies such as China and Venezuela. Some observers of Cuba believe the Cuban government would like to adopt a China-like model of foreign investment whereby Cuba grants market access for foreign capital and technology in exchange for only minority foreign ownership (O’Grady, 2007).

On the other hand, foreign investors have to jump through hoops to accommodate US trade and investment restrictions imposed by the US-imposed trade embargo. In anticipating an end to the US trade embargo, after two years of negotiations, in late 2007 Dubai Ports World, a partly state-owned company in the United Arab Emirates, agreed to invest $250m in upgrading the aging port in Mariel into a modern container facility that is due to open in 2012 (The Economist, 2007b).

Cuba’s peculiar domestic dual-currency regime -- the Cuban peso, CUP, for which prices and wages are denominated in the domestic economy and a convertible peso, CUC, which is used in “hard currency” retail establishments -- has its provenance in the legalization in the use of the US dollar that was part of the government’s response to the economic crisis in the 1990s that was spawned by the earlier collapse of the Soviet Union. By the end of the “special period” of austerity the ban on the use of the US dollar was reinstated, and the convertible peso, CUC, replaced the US dollar for all transactions between Cuban entities operating in hard currency, and also replaced the US dollar in all domestic hard currency retail outlets. In addition, there is a 10% surcharge when exchanging US dollars into CUCs.

Even though the “official” -- and fictional -- exchange rate is fixed at parity between the CUP and the CUC (as is the rate of 93 CUCs equal to a US dollar), the “unofficial” (though legal and more realistic) exchange rate for personal transactions is approximately 24 CUPs equal to 1 CUC (EIU, 2010). The social and political consequences of this dual-currency system are not negligible: it has impoverished hundreds of thousands of Cubans. The government pays salaries with nearly worthless CUPs that can be used to purchase heavily subsidized -- though tightly rationed -- monthly staples, while severely restricting the distribution of CUCs that can be used in the “hard currency” shops to purchase much sought after “luxury” goods such as shampoo, household appliances, and electronic goods, all at premium prices. As a result, Cuban society is being divided into “have’s” and “have not’s”: Those who, by virtue of their job (or through some extra-legal way), have access to tourists (with hard currency that can be exchanged for CUCs) versus those being paid -- the overwhelming majority of Cubans -- in CUPs. Maintaining this detested dual-currency system has become one of the most glaring irritants of Cuba’s failed economic system.

An Active Government Policy to Promote Social and Economic Investment

The last of the four World Bank “ingredients” to be included in a well-managed national economy that is ready to meet the challenges of -- and reap the benefits from -- the global economy of the 21st century is an active government policy that promotes social and economic investment, especially in the areas of health, education, and physical infrastructure, including transport, telecommunications, and energy.

In addition to guaranteeing basic nutritional needs and employment, the Cuban Revolution raised the provision of health care and education to almost mythical levels for Cubans. After years of emphasizing the universal provision of basic food needs and health care, Cuba's health statistics are comparable to those that characterize industrialized countries, especially in measures such as life expectancy and infant mortality (EIU, 2008).

Even though the economic crisis in the early 1990s adversely affected public health because of shortages in food, medicines, and equipment, with the recovery of the economy, caloric intake levels increased. In 2007, State spending on health was 12.5% of GDP, so the focus for assessing the program should be directed at the efficiency of the system, a subject that goes beyond the scope of this paper. (Similar questions can, and are, being raised regarding the celebrated -- and, in some instances, the much criticized -- US health care system). With an eventual lifting of the US trade embargo, Cuba has signaled interest in developing the potential for "health care tourism" as another source of critical foreign exchange in the future.

As recently as 2008 Cuba boasted the highest literacy level and the highest levels of educational attainment in Latin America (EIU, 2008). However, as in the case of the health care sector, the serious fiscal problems and the acute shortage of foreign exchange since the early 1990s resulted in a very visible deterioration in the condition of the education "physical plant" as funding for modernization and maintenance were drastically reduced. In addition, low wages for educational professionals (along with competition for labor in the higher paying tourism and informal sectors) resulted in a shortage of qualified teachers. In 2007 spending on education was estimated at 14% of GDP, an increase from 6.3% in 1998, and spending on education is expected to grow in the future as Cuba installs "state-of-the-art" information technology in its schools (EIU, 2008).

As was the case for the other "infrastructure goods", the Cuban road network suffered similar degrading during the economic depression of the early 1990s that resulted from the shortage in funds for road maintenance. Because of the (continuing) restrictions on private car ownership, automobile density rates and miles driven remain low by international standards. However, bus travel and the condition of the road network have improved measurably from 1998-2004 as a result of a joint venture with a Brazilian company, Busscar, and, more recently, thanks to Chinese financing that facilitated imports of Chinese buses, and funding that provided for road repairs.

Chinese and Venezuelan credits are playing a critical role in modernizing Cuba's rail sector, both track and rolling stock. The rail system fell into disrepair after the decline of the sugar industry, which was the major client of the Cuban railway. With financial support from Venezuela, Cuba is planning to modernize the system so that average rail speeds will triple over the current average of 34 km/hour (EIU, 2008).

With respect to Cuba's communications infrastructure, the chronic under-investment in telecommunications began to be addressed in 1994 as joint ventures were formed between the state telecoms provider and a Mexican, and later, an Italian company, leading to an improvement in service reliability. However, in 2007, telephone density was only 100 lines per 1000 population, half the average of the Latin American and Caribbean region (EIU, 2008). Cellular services were extended to individuals for personal use in 2003, but mobile subscriptions are low because bills must be settled in expensive CUCs (convertible pesos). Since 2009, US telecoms companies may invest in Cuba (Levine, 2009).

Since Cuba is not yet connected to an international cable link -- US legislation prohibits connection at the US end of the fiber-optic cable to Florida -- and the US has blocked a Cuban link to Jamaica, Cuba's international access is dependent on a limited-bandwidth satellite link. Ironically, this serves the interests of the government since without strong international linkages the government can continue to restrict Cubans' access to information other than that provided by the State-owned press. As was mentioned above, access to the Internet is still restricted to government offices, research and educational institutes, and enterprises. A national fiber-optic network was completed in 2004, and, again with the help of

Venezuela, there is a plan to lay a 1500 km cable to link Cuba with the rest of Latin America and the Caribbean (EIU, 2008).

Turning to Cuba's energy infrastructure, electricity is overwhelmingly generated from domestically produced (heavy crude) oil and from natural gas produced as a by-product of oil output. During the austerity years in the 1990s, a shortage of feedstock caused severe disruptions in the provision of adequate supplies of electricity. In 2006, Cuba launched an "energy revolution", the centerpiece of which was a much more decentralized network (with local generators and back-up facilities) to reduce dependence on a few large generating plants that were previously used as the core of the system (EIU, 2008). However, despite the fact that the grid modernization was financed, in part, by a substantial increase in electricity prices at the end of 2005, as recently as late 2009 Cuba was rationing air-conditioning to five hours a day (The Economist, 2009b).

CONCLUSION

Despite the "laundry list" of weaknesses in the Cuban model enumerated in Part 4, above, and the concession made last year by Fidel Castro, himself, that the Cuban model no longer worked, to date serious economic reform has remained elusive (Azel, 2011).

To be sure, Cuba is a small country in both geography and population, especially when contrasted with its behemoth neighbor 150km to the north. Nevertheless, Cuba does have "economic assets" that, if properly developed and managed, can be deployed for the purposes of increasing economic growth, employment, and living standards. Some of Cuba's strengths are "God-given", such as its nickel and potentially large offshore petroleum deposits. Some are "geographical", such as its proximity to the (still) richest consumer market in the world that can be served by a "state-of-the-art" container port, a modern liquefied natural gas terminal in Cubato, and a potentially "world-class" tourist "get-away" for millions of winter-weary northern hemisphere affluent consumers. And finally, some are anchored in the "human capital" of its population through the educational and medical services they can offer to developing countries.

However, under Cuba's current leadership and its ossified mindset with regard to human, political, and technological – that includes press and Internet -- freedoms, Cuba's continuing ostracism from regional, hemispheric, and in some cases, global institutions contributes to preventing Cuba from "unlocking" its valuable assets -- including the large and successful Cuban Diaspora in the US -- for the benefit of all the Cuban people.

It is important to note for the purposes of context that there are many "small" countries in the world that are vulnerable to the pressures of large, powerful, and, often, aggressive neighbors. Examples abound: Uruguay, wedged between Brazil and Argentina; Finland and the Baltic States, historically exposed to the seemingly unbounded expansionary designs of Russia; as well as some of the "small" Asian countries such as Nepal, lodged between China and India. Somehow, some way, most of them have found a "modus operandi" to live with their oversized -- and often oppressive -- neighbors, something that the Cuban leadership, to date, has been either unwilling or unable to do.

Because of the Castros' long-lived personal animosity toward the US, Cuba has consistently (and disastrously) been forced to "depend on the kindness of strangers", first the Russians, then the Venezuelans, and, most recently, the Chinese, to provide for the shortfall in the basic ingredients of living standards – food and energy – and financial credits.

To conclude, over the last half-century geopolitical alignments, technology, human rights norms, and financial conditions have all undergone profound change throughout the world. As this paper has argued, one of the few countries still frozen in the mindset of another age is Cuba. It appears that in order to unlock the country's considerable physical and human assets, first the "curtain will have to fall" on the Castro era.

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