

Investing in Cuba

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Renewal of relations with US heightens expectations

Tentative signs of openness raise hopes, but is the island ready to do business? By *John Paul Rathbone*

There is a new entry among Cuba's roll of important dates. Alongside Fidel Castro's 26th of July movement and the January 1 1959 "triumph of the revolution", there is now December 17 2014.

That was the day when Barack Obama and Raúl Castro, the US and Cuban presidents, announced that they wanted to normalise bilateral relations and end more than 50 years of cold war enmity.

To be sure, communist Cuba was already changing. After formally becoming president in 2008, Mr Castro began a tentative economic liberalisation process to boost the country's flag-

ging economy — especially urgent now that Venezuela's growing crisis jeopardises the \$1.5bn of aid it sends every year.

But the December 17 announcement lit a bonfire of expectations among US businesses — even if Cuba's \$80bn economy, for all its exotic allure, is much the same size as the Dominican Republic's.

"There is a new sense of excitement, of US companies coming to look and thinking of starting seed businesses," says one long-established European investor in Havana. "It makes sense. Start small, learn how the system works and then see how it all goes."

So, how might it all go? US and Cuban officials have warned that expectations



Diplomatic flurry: (top to bottom) Raúl Castro meets President Obama, Pope Francis and President Putin; Fidel Castro with François Hollande in May

Reuters: Getty

are too high. "Prospects [in Washington] for lifting the embargo in the short term are dim," cautions Michael Shifter of the Inter-American Dialogue think-tank.

The notion that US businesses and tourists might soon turn Cuba into a Disney-style communist theme park with McDonald's outlets spread along Havana's seafront is also unlikely; Havana has run its own government for 56 years and is proud of its sovereignty.

Furthermore, even if the US embargo were to end overnight, the island still faces an "internal embargo" — the thicket of Soviet-style bureaucracy and centralising socialist attitudes that makes doing business difficult.

"All of Raúl's economic reforms



Even if the US embargo ends, an 'internal embargo' remains — a thicket of Soviet-style bureaucracy

involved decentralisation, which is good, as Cuba needs that," says Rafael Hernández, editor of *Temas*, a state-published cultural magazine. "The problem is this . . . has not happened."

Still, change is coming to Cuba, however slowly, and one way to mark the changes is to travel back to Pope John Paul II's 1998 visit. "Do not be afraid," he said. "May Cuba, with all its magnificent potential, open itself to the world, and may the world open itself to Cuba."

Today, Cubans appear less afraid. Activists are still hounded, but there is a willingness among many to speak their

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Investing in Cuba

Reconnected after 55 years but overtures divide opinion

Diplomacy Renewed relations play well in the US – although not with everyone, writes *Geoff Dyer*

Barack Obama surprised the world in late December with the announcement that he planned to normalise relations with Cuba, bringing to an end more than five decades of diplomatic estrangement from the island nation 90 miles south of Florida.

In April, he held his first proper meeting with Cuba's President Raúl Castro at a summit in Panama. "The United States will not be imprisoned by the past; we are looking to the future," President Obama said. "I'm not interested in battles that started before I was born."

But six months after the original announcement, what has emerged is a much more patient and cautious opening between the former adversaries.

The Obama administration is working on two fronts. It is trying to use a modest relaxation in business and trade with Cuba to press the government into more political reform. At the same time, it hopes to wear down resistance in the US Congress to a broader relaxation of the nearly 55-year embargo. For US companies keen to jump into a new market, it is likely to be a slow process.

So far, the administration's policy changes towards Cuba have

been limited to what is possible through executive orders issued by the president.

The White House has made it somewhat easier for Americans to visit Cuba and has issued a licence for a ferry service from Florida. Restrictions remain, but tourists report there is little attempt by US authorities to check whether they qualify for one of the 12 categories of

Difficult call: President Obama (top) talks to President Castro in December; (below) US senator Marco Rubio is a critic — Getty



approved travel. Another order made it easier for US companies to sell telecommunications equipment to Cuba.

In late May, the administration formally took Cuba off the list of state sponsors of terrorism. While largely symbolic in terms of helping US companies do business in the country, it is an important step in legitimising relations. US officials say an agreement is close on opening formal embassies – at the moment, the US has an "interests section" in Havana.

Despite the hype, most restrictions on US companies remain. More substantial changes will require Congress to start peeling back the web of laws that make up the economic embargo.

"This is only the door cracking open," says Peter Kucik, a sanctions specialist at the Inle Advisory Group in Washington. "It is the beginning of the process."

How will Congress respond? One of the most surprising aspects of Mr Obama's policy is how popular it has been. Not only have polls shown broad public support for the push to normalise relations with Havana, but some have shown a majority of Cuban-Americans in favour of the move.

In Congress, there has been bipartisan support. On board the



plane to Havana in December that brought home Alan Gross – a US contractor whose release from a Cuban jail after five years was an effective prerequisite for the Obama announcement – was Republican senator Jeff Flake.

But there is also a bipartisan group of members of Congress and other senior figures who are bitterly opposed to any further rapprochement with Cuba, including three potential candidates for the Republican presidential nomination – senators Marco Rubio and Ted Cruz and former Florida governor Jeb Bush.

In early June, the Floridian Mr Rubio said he would block efforts to appoint an ambassador to Cuba if the administration did not first introduce far-reaching political reforms and settle billions of dollars of legal claims over property nationalised by the government.

Given such a climate over the idea of sending an ambassador to Havana, few analysts are expecting Congress to make any significant changes to Cuba sanctions legislation in the near future.

As a result, the administration is developing a longer-term strategy of using modest changes to build a case for relaxing more restrictions. The changes to date have been designed to encourage the sorts of private entrepreneurship

that escape the controls of the state – an oblique way of putting pressure on the Cuban government but also of showing critics at home the potential for further engagement.

By making it easier for US companies to export telecoms equipment to Cuba, the administration is clearly trying to boost the sort of internet access and other communications that might subtly undermine political control.

Last month, US-based IDT Corporation announced that it had signed a contract with the Cuban telecom company to provide direct phone links between the two countries.

After Mr Rubio used a recent Senate hearing to claim the Cuban government would be the main beneficiary of more US tourists, Mr Flake brought out his tablet to show off the new operation in Cuba of Airbnb, the holiday home rental site. "If you just scroll down, they have now more than 2,000 listings in Cuba," he said. "Virtually all these listings are people in their homes."

Ted Piccone, an expert on Latin America at the Brookings Institution in Washington, says that Airbnb's Cuban business is a good example of "how US companies can do business in Cuba in ways that empower Cuban people".

Renewal of relations with US heightens expectations

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minds, and some official tolerance too.

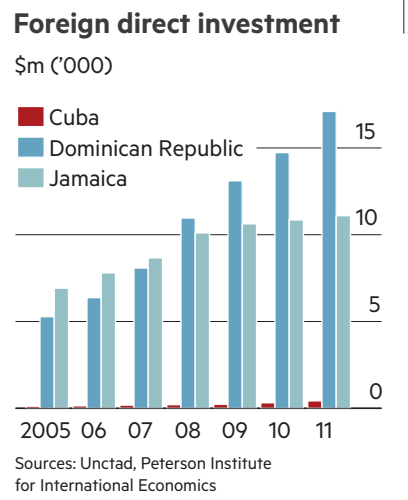
One sign of this is the continued existence of news website 14ymedio.com, set up by dissident journalist Yoani Sánchez – even if limited internet access means few of Cuba's 11m people can read it.

The world has also begun to open up to Cuba. Before December 17, there were only 35 enquiries from foreign investors about Mariel – the \$800m port and free trade zone on Cuba's northern coast (see page 3), built by Odebrecht, a Brazilian construction company, and operated by Singapore's PSA. "After December 17, there is talk of 300 enquiries," notes Emilio Morales of the Miami-based Havana Consulting Group – although how many of these enquiries turn into actual investment is another matter.

The embargo, whose removal requires settling tricky issues such as \$7bn of US nationalisation claims, puts a brake on US businesses. It can also put a brake on third-country businesses, too.

"We have to be entirely self-financed," comments one European resort operator. "The new US approach has been 'that may be no longer illegal, but it is not necessarily legal either' – which makes financing problematic."

Lastly, Cuba is opening to the world, albeit slowly. The Communist party is torn between letting reforms rip and



Glimmers of glasnost begin to warm island

Politics

The government retains a tight grip, but there are signs it is loosening a little, writes *John Paul Rathbone*

Shortly after the US and Cuba announced talks about normalising relations, a neighbourhood watch committee – often a bastion of communist prying – held its regular Committee for the Defence of the Revolution meeting not far from Havana's Interior Ministry.

According to witnesses, many of the government stalwarts there were wary of the new US approach. "You can't trust the Yankees. Their opening is a Trojan horse," was the general tone. Others saw the prospect as an opportunity for themselves, their families and their country. Yet they muffled their opinions out of habit and, perhaps, of fear. In later meetings, they slowly voiced their views.

The anecdote is emblematic of the state of Cuban political debate. It is cautious, often suspicious, and the state keeps a firm grip. But spaces for political argument are slowly opening up, thanks in part to President Raúl Castro's encouragement of economic criticism.

The process is relevant particularly to foreign investors, who will encounter wildly contrasting attitudes depending on which bureaucrats they deal with.

The journalist Yoani Sánchez is part of a fledgling independent media tolerated by the government



"The Tourism Ministry is businesslike and open-minded. They are mostly pragmatists drawn from the military who have long dealt with foreign businessmen," notes a European diplomat. "The agriculture ministry, by contrast, is still Soviet – closed, suspicious and hard to deal with."

In the press, there are dull organs such as Granma, the official Communist party newspaper, which even Mr Castro has called an "insult to the intelligence". But their main alternative is a fledgling independent media – such as Havana Times, a bilingual website, and 14ymedio.com, set up by dissident journalist Yoani Sánchez – where coverage is lively, well reported and often polemical.

Only 5 per cent of Cubans have unfettered internet access, but the news sites suggest growing tolerance of dissent. This can be seen on officially sanctioned online forums. In one sponsored by the Union of Young Communists, an anonymous poster asked: "I would like to know if direct elections for the principal leadership positions of the country are under consideration . . . the current system is [in my view] highly unpopular."

Glimmerings of glasnost can be seen in debating groups such as that hosted by Temas, a state-sponsored cultural magazine, or independent groups such as "Cuba Possible", whose website carries a range of opinion pieces from diehard communists and exiled dissenters.

Such shifts do not portend imminent political change. Dissidents can travel abroad but extreme views are punished in Cuba. Last year, there were almost 9,000 short-term arrests of pro-democracy activists, dissidents say. However, there has been a 5 per cent drop in detentions in the first four months of this year.

"That drop is a potentially positive sign of the effects of the December 17 announcement of the US-Cuba talks," another European diplomat said.

The US wants to press the issue of human rights but the process is difficult. Talks about re-establishing embassies almost bogged down over the US desire to promote human rights from Havana. US political rhetoric can also colour the domestic economic conversation.

Rafael Hernández, editor of Temas, notes: "Raúl Castro has said the private sector is not an agent of capitalism, and has spoken of the need to end old habits of thinking. But for the US, the private sector is an agent of capitalism. So there is a problem of rhetoric on both sides."

Many analysts argue that the faster the US embargo ends, the faster reforms will happen – and vice versa. (Critics hold diametrically opposed views). Either way, next April's party congress will be a barometer of the government mood.

Mr Castro, 83, says he wants to deepen economic reforms, and so boost the probability of a soft landing for 2018, when he says he will retire. Retirement need not, however, preclude him from remaining head of the party, where power ultimately resides, or from appointing someone from his inner circle to become the next president.

"Cuba is a long game," notes one US official of the island's transition. "Patience, much patience," is required, as Mr Castro himself has said.

maintaining control. Little surprise that results are disappointing – as was tacitly recognised by Mr Castro, who wants to deepen reforms, increasing the chances of an economic "soft landing" in 2018, when he says he will retire as president.

"Dealing with the internal embargo is one of Cuba's biggest challenges," says Pedro Freyre of US law firm Akerman. "The state might want to let small businesses grow . . . but then it often taxes, regulates and clobbers them." One sign of ambivalence is the emphasis on state-sanctioned co-operatives, rather than the 500,000 self-employed workers.

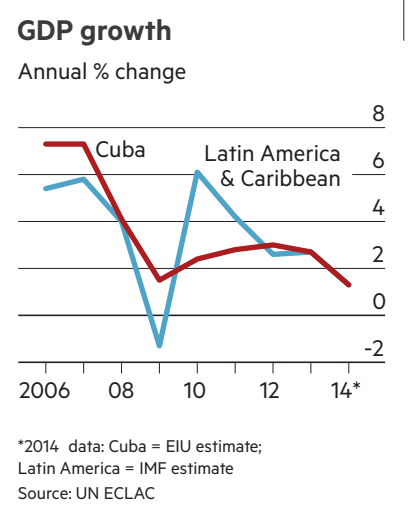
Cuba also suffers from limited bandwidth to deal with foreign interest. That is as true of Havana's stretched tourist capacity as it is of Cuban officials with sufficient authority to make decisions. Mariel's six approved projects, for example, required approval from the Council of Ministers, the highest authority.

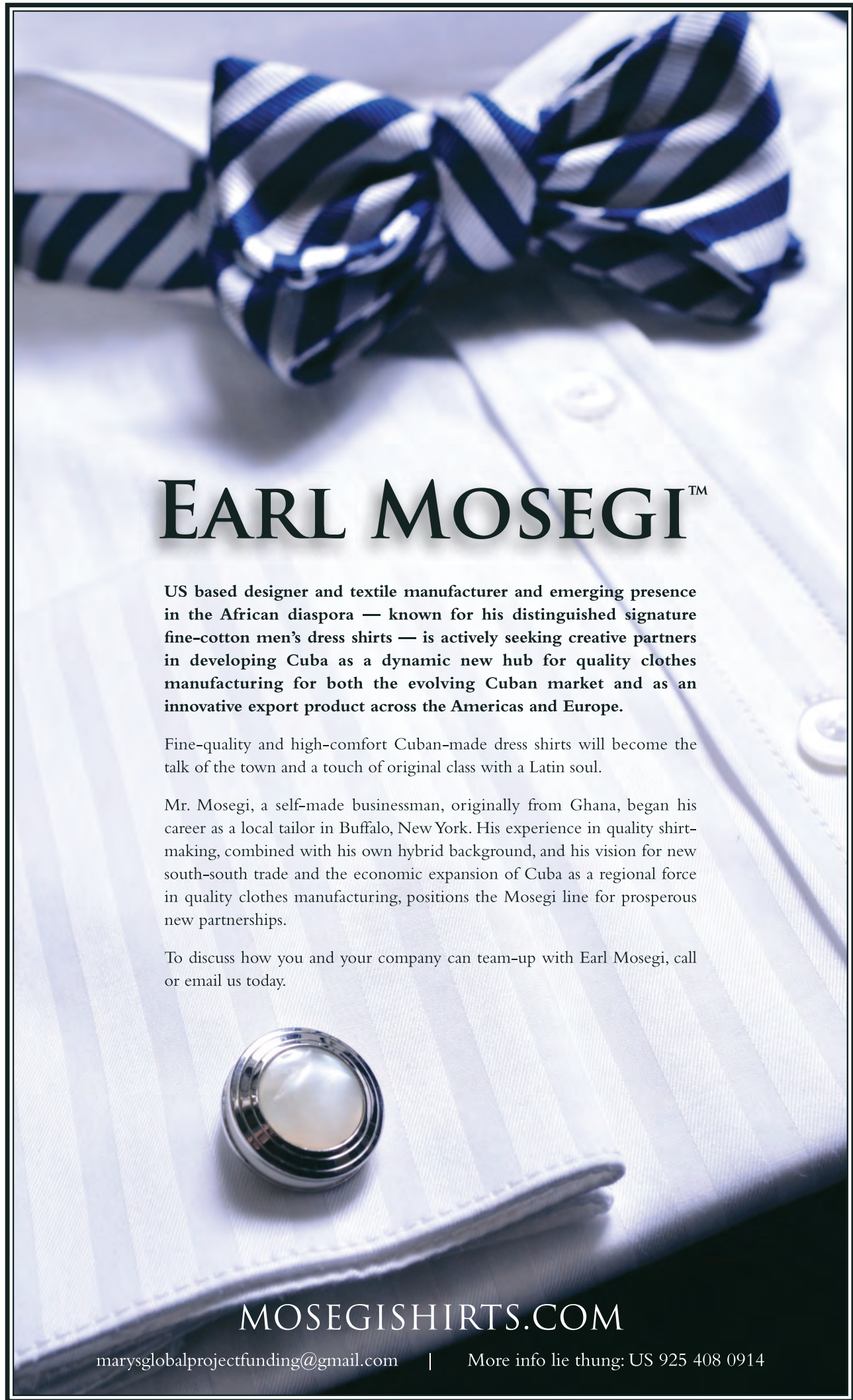
Even so, there is strong business interest in Cuba's so-called "knowledge economy", especially biotechnology. A handful of large foreign corporates – such as Canadian miner Sherritt International, and France's drinks maker Pernod Ricard and telecom's group Bouygues – set up profitable businesses years ago. So too, more recently, have émigré mom-and-pop entrepreneurs from Miami.

At Miami discount store Noo! Que Barato! (or "Wow! How cheap!") Cuban-Americans can buy school uniforms for relatives' children. The island's recent flowering of private restaurants and hotels – mostly refurbished private homes – is also largely financed by Cuban-Americans, who remit up to \$2bn annually to relatives.

The message from foreign businesses in Cuba is that the island is a potentially exciting market for anyone content to wait for uncertain and long-term returns. In the meantime, a word of caution about the surge of private foreign interest in Havana property, where purchases are possible only via a resident Cuban partner, who then has legal title.

"The outsider takes all the risk," says one European businessman. "I've heard as many unhappy as happy stories."





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Investing in Cuba

Straits dealing bridges many gaps

Diaspora Retailers in Florida cash in on items needed by customers across the water, writes *Cardiff Garcia*

Serafin Blanco has been described as the Florida Cuban émigré community's equivalent of Sam Walton, the founder of Walmart. But the merchandise he sells mostly ends up back in Cuba, which he has not visited since he left nearly 50 years ago as a teenager, and where he has no stores.

"People in Cuba still need a lot of things they can't find," he says, "and they deserve a good life."

Mr Blanco owns Nooo! Que Barato! (which roughly translates to "Wow! How cheap!" though some suggest a coarser interpretation), a store spanning 40,000 sq ft in the working-class city of Hialeah, near Miami, where three-quarters of residents are Cuban or Cuban-American.

He is among a group of local vendors who are famous to visitors from Cuba and their Florida relatives, selling cheap items that are in short supply on the communist island and expensive for the average Cuban. These retailers, like the Cuban-Americans who send more than \$2bn in cash remittances annually, have provided a source of capital for families and a growing number of privately run small businesses in Cuba for years.

"Hialeah is the blue-collar underbelly of a vibrant economy," says Joe Scarpaci, executive director of the Center for the Study of Cuban Culture and Economy.

Mr Scarpaci, who recently wrote an article about the economic ties between Hialeah and Cuba in the journal Focus on Geography, sees a day when these vendors can use their existing brand recognition to open franchises in Havana if Cuba liberalises enough.

For now, the items sold by these outlets reflect the oddities of the Cuban economy and highlight the importance of this economic lifeline. Owing to the US embargo on trade and historic ties with Russia, for instance, the modern cars used as taxis are Russian, not American.



Primary colours: Serafin Blanco, founder of the Nooo! Que Barato! store, with school uniforms in Cuban hues — AP

Often the spare parts are scarce. Fabián Zakharov, whose father is Russian and mother is Cuban, imports the parts from Russia to his shop in Hialeah and sells them to Cuban customers.

"It's very common for people to ask two questions when they come to me," he says in Spanish. "First, how much does the part weigh? And second, how much are the taxes on it?" He refers to arbitrary charges imposed by Cuba for importing certain parts and the rules governing the amount of cargo that can be carried into the country.

Internet access in Cuba is unavailable in the home and prohibitively expensive outside it. Yoel Juarez therefore sells old Gateway laptops for \$150 along with dial-up modems that Cubans can use to go online illicitly at their workplaces.

Mr Blanco sells reusable diaper pins, which appeal to Cubans who cannot afford or find disposable diapers. School uniforms for Cuban children are always in demand and easy to find in Hialeah, where students wear burgundy outfits that closely resemble those of their counterparts in Havana.

These stores often pack items tightly into an easily carried bundle. Direct mail between the US and Cuba remains banned, and the packages are normally taken to Cuba in person on charter flights that shuttle between Florida and Cuba. When families and businessmen cannot make the trip and prefer to avoid the commission taken by the Cuban government on the shipment of goods, they sometimes hire a *mula* (mule) as an informal messenger to deliver them.

The commerce that connects Hialeah and Havana is in contrast to the fractiousness — perceived and real — that long defined the relationship between Cubans and their former compatriots now in Florida, the exiles whose businesses and homes were expropriated by the Castro regime soon after its revolution in 1959.

Those tensions remain but are now easing. Hardline Cuban-Americans, who advocate a policy of isolating Cuba and the continuance of the US embargo on trade and travel, are ageing and losing political influence. Meanwhile their children and grandchildren prefer a

better diplomatic relationship with Cuba, as do the Cuban immigrants who arrived more recently.

Such attitudes are increasingly visible on both sides of the Florida Straits. In Cuba, 97 per cent of citizens believe that a normalised relationship with the US would be good for them, according to a recent, secretive poll conducted by the consultants Bendixen and Amandi.

"I'm not going back to Cuba unless the Castros are gone," says Angél Elías, who left three decades ago and considers Florida home. But on a Thursday afternoon, he is happily escorting his elderly mother through the aisles of Nooo! Que Barato! She lives in Matanzas, Cuba, and will return with clothes and toys that Angél buys for her to give to his siblings, nieces and nephews.

Such scenes are typical here, with familial ties and economic needs bridging the gaps imposed by politics and geographic separation.

"It's a beautiful story that most people don't have a clue about," Mr Scarpaci says. "And the moral is simple: blood always trumps politics."

US companies Still facing investment hurdles

"There was a kind of euphoria after last December," says Pedro Freyre, who chairs the international practice at law firm Ackerman and advises US companies on Cuban issues. "But now, companies are realising that it makes sense to kick the tyres first before investing in Cuba."

Despite improved relations since President Obama's announcement last year, US companies seeking to invest in Cuba still see more roadblocks than welcome signs. The US embargo on trade and travel remains and requires an act of Congress to overturn. But this is not the only impediment.

Most of Cuba's 11m citizens are very poor, which limits market opportunity, and infrastructure is corroded. Gary Hufbauer, fellow at the Peterson Institute for International Economics and co-author of *Economic Normalization with Cuba*, emphasises the flawed incentive structure of the statist model. Investment is inefficient because of bad data and a workforce with little experience of big projects.

The distorting effects of the embargo and communism have also produced idiosyncratic obstacles for US companies.

Taking Cuba off the government's list of terrorism sponsors makes it easier for financial institutions to offer services there. Yet doing so would continue to pose a regulatory risk for US banks, which might worry about their liability if they process a customer transaction that runs foul of the embargo or laws that govern money laundering.

MasterCard removed its block on the use of its US-issued credit cards in March, but the banks that issue the cards decide whether they will work. They have declined so far, as the risk may be small but is still hard to justify.

It is a balancing act, says Yosbel Ibarra, co-chair of the Latin America practice at Greenberg Traurig, the law firm. "What are the bank's compliance costs? How much money can be made? It's complicated. Though I also think that it's just a matter of time."

Telecommunications companies could try to capitalise sooner. IDT Corp became the first US company to offer direct, long-distance telephone calls to Cuba after a deal in March with ETECSA, the state telecoms company.

But ETECSA will not allow IDT to offer other services, such as sending top-up mobile minutes to relatives in Cuba, and fees imposed by the Cuban government for calls from the US are some of the highest in Latin America.

To the rest of the world, tourism is Cuba's most appealing economic sector, and it is growing. The number of tourists climbed by 36 per cent in the first quarter from the 2014 figure, and available bedrooms at hotels or privately run *casas particulares* have been hard to find lately, according to economist Omar Everleny of the University of Havana.

Arnold Donald, chief executive of cruise line Carnival, cites "pent-up demand" and the country's proximity to the company's main port in Miami. Yet cruises to Cuba almost certainly cannot begin until the embargo, which prohibits American tourism to Cuba, is lifted. Certain categories of travel are permitted — for journalistic activity, cultural exchange, to visit family — but it is unrealistic to fill a cruise ship with people who satisfy these criteria.

A different set of challenges awaits US hotel groups, should they try to set up in Cuba, says Mr Hufbauer: "Any US company [considering future

FT **Gone, not forgotten**
What now for legal claims by Cubans and Americans who had property expropriated?
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investment] must do its own strategic analysis about whether it will eventually want to compete with state-owned enterprises or partner with them."

The state typically insists on having a majority stake in partnerships with foreign companies. And for now, Cuba's dual-currency system effectively functions as a tax on this sector (see page 4).

Similar obstacles arise in other sectors, and they all point to the same conclusion.

The promise of closer diplomatic ties is exciting, but without an end to the embargo and a further liberalisation of the Cuban economy, US corporates can only wait, watch and prepare.

Cardiff Garcia

New port zone harbours big ambitions

Development

A would-be capitalist enclave in a socialist state, Mariel is emblematic of change in Cuba, writes *Marc Frank*



Eye to the future: the cranes of Mariel

Waves of foreign businessmen have washed up on Cuba's shores since the thawing of US-Cuba diplomatic relations. They are following such prominent figures as the president of France, foreign ministers of Japan, the Netherlands and Norway, the commerce secretary of Spain and the EU's foreign policy chief, Federica Mogherini.

Invariably, the delegations want to see the new Mariel port and container terminal west of Havana, and the surrounding Chinese-style special development zone. The terminal is meant to lure ships from a renovated Panama Canal, and the free-trade zone is a would-be capitalist enclave in a staunchly socialist country.

But like waves receding from the island's beaches, the visitors have left little in the sand. While some are looking to set up shop in the next few years, most await further evidence of a new Cuban attitude, and that the change in US policy will lead to more progress in the contentious relationship.

The Mariel special development zone is a metaphor for Cuba, a work in progress whose future appears both bright and clouded by risk. The terminal, built with Brazilian credit and managed by Singapore's PSA, is poised to boom if the US embargo is lifted. It anchors the zone, with a competitive tax and customs regime. But this vast area still lacks basic infrastructure, development and a competitive edge in terms of property ownership, labour policy and the legal environment.

In Mariel, as elsewhere in Cuba, investors must go through a government hiring hall for labour, ostensibly designed

improving relations with the US; negotiations to normalise relations with the EU; restructuring debt; Mariel; tax incentives for investors; and expansion of a private sector and market forces.

The Communist party adopted a comprehensive reform plan in 2011 that pledged to "enhance Cuba's credibility in its international economic relations by strictly observing all the commitments that have been entered into".

While companies inspect Mariel, the dignitaries leading the delegations have held talks with Cuban leaders, where re-engagement with the global economy and debt have been high on the agenda.

The reform plan calls for hastened rescheduling of Cuba's foreign debts and implementation of "flexible restructuring strategies for debt repayment" soon. In recent years, Cuba has restructured its debts with Russia, China, Japanese commercial creditors and Mexico as a prelude to more investment, and has made payments on time to suppliers and creditors. The Economist Intelligence Unit puts the debt at \$25.8bn, some \$8bn of which represents defaulted debt.

When François Hollande, the French president, visited Cuba last month, he told companies in his delegation that Havana and the Cuba Working Group of the Paris Club of western creditor nations had reached agreement on the amount owed from a 1980s default.

"The first phase is over," Mr Hollande said, referring to the work needed before formal negotiations start. Cuba owes Paris Club members about \$15bn in defaulted debt, interest and service charges. France, Japan, Spain and Italy hold much of it.

The Paris Club negotiations are expected to begin before the end of the year and will be the first multinational attempt at restructuring in 15 years. Success would open the way to settling old commercial debt held by the London Club and eventually access to multilateral lending organisations if the US lifts opposition to Cuba's membership.

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Photo: Sebastian Agudelo

Investing in Cuba

Moves to unlock the nation’s wealth of knowledge

Specialist skills

With strengths in science and computing, Cubans have money-spinning expertise, writes *John Paul Rathbone*

Technically, it is called a skills mismatch, and Cuba has it in abundance. Take the Havana taxi driver who tells you he is in fact a surgeon, or the waitress who is, in fact, a physicist.

Skill mismatching represents the cost of misinvested human capital, and thus economic inefficiency. But the state and some foreign investors want to turn it into a boon, and the ground source of a future “knowledge economy”.

“Cuba’s knowledge economy is stronger than people often credit,” says Faquiry Diaz Cala, a Cuban entrepreneur now living in the US. “It has one of the hemisphere’s highest literacy rates, one of the highest college graduate rates, and PhDs in hard sciences . . . One should think of Cuba as a start-up nation, with some similarities to Israel.”

Even if the comparison is a big stretch, Cuba’s health sector holds immediate

promise and other sectors, such as computing, have also drawn foreign interest.

The government has made medical services a money spinner: some 12,000 Cuban doctors work abroad in Africa, 30,000 in Venezuela and about 12,000 in Brazil and elsewhere in Latin America.

Their services are sold by Cuba, which pays the doctors a smaller fraction. This brings in billions of dollars a year — a system critics call a tacit form of indentured labour, although medics earn more abroad than at home and enjoy perks on their return. Some reportedly bribe officials to bump them up waiting lists to go.

Now, foreign health groups want to get in on Cuba’s commercially untapped pharmaceutical expertise. In May, US research centre Roswell Park agreed to begin clinical trials on a Cuban-developed lung cancer vaccine, Cimavax.

“We know [the drug] is not an easy one to develop clinically,” said Philippe Pouletty, chairman of French biotech company Abivax. “But it is good news that a US cancer institute evaluates it and that the FDA [US Food and Drug Administration] builds confidence in Cuban products.”

Abivax has operated in Cuba for five years, building relationships with research institutes, using investments

and agreements to trial and commercialise Cuban drugs — such as a vaccine to help chronic hepatitis B sufferers — and also to develop new drugs.

Mr Pouletty, a venture capitalist and qualified doctor, says that if Cuba’s biotech capability was floated into a listed company, it might be worth \$20bn. But he stresses: “We don’t think it is the biggest cheque that persuades the Cubans. They are looking for sustainable growth; short-term, medium-term and particularly long-term solutions.”

He says Cubans are slowly feeling their way into new language such as “spin-offs”, and are still getting used to notions such as foreign joint ventures requiring them to surrender full control.

But he adds that he is “pathologically optimistic” and points to a new “Silicuban” advisory board, designed to help Cubans develop their drug industry and “where all things can be said without censorship”. Another positive sign is the separation three years ago of the three main research institutes into a holding group, BioCubaFarma, a move that freed them from the Ministry of Health’s heavy bureaucratic hand.

Computer programming is also promising. Local computers are so old and slow that Cubans have become adept at

writing lean software programs that require little memory to run — a skill ideal for writing mobile apps. The state has commercialised some of this expertise through Datis, which sells computing and internal security expertise to allies such as Venezuela that use it for administration, such as identity cards.

Privately harnessing such knowledge is another matter. Difficulties are compounded by poor internet availability, a barometer of Cuba’s willingness to embrace the “knowledge economy”.

The government says it wants half the population wired by 2020, to boost productivity. Yet it is reluctant to permit such a powerful tool as it would mean ceding control. There have been small trials of public WiFi, but most Cubans can only get online for \$4.50 an hour at internet cafés in hotels, a quarter of the average monthly state wage.

On a recent visit to Miami, organised by the Cuba Study Group, a US organisation that promotes US-Cuban engagement, island entrepreneurs were agog at the possibilities of online retail and rued Cuba’s poor connectivity. Airbnb’s Cuban operations, for example, are often run by a relative abroad, who communicates internet bookings with the guest-house operator via telephone or SMS.

‘One should think of Cuba as a start-up nation, similar to Israel’

Faquiry Diaz Cala, entrepreneur

Could communist isle be Vietnam in the Caribbean?

OPINION
Richard E
Feinberg

What might Cuba look like a decade or two from now, when its ageing revolutionary leadership has faded from view? Consider the remarkable economic success of Vietnam, once a highly centralised planned economy as Cuba is today.

Vietnam has evolved into a hybrid system with a dynamic interplay between a hefty public sector of state-owned enterprises, a vibrant and expanding private entrepreneurial class and an influx of global brands: the likes of Nike, Honda, Canon and Samsung employ millions of Vietnamese.

Vietnam’s surging economy is also well diversified, exporting rice, fish and minerals, hosting tourists and participating in cross-border manufacturing supply chains. Domestically, the construction and real estate businesses — driven by foreign and domestic investors — are booming, and efficient telecommunications empower the ambitious Vietnamese middle classes to fixate on Facebook.

By the standards of developing countries, Vietnam’s big cities are refreshingly people-friendly. Hanoi is proud of its greenery while Ho Chi Minh City is attractively remodelling the banks of its winding canals. Abundant affordable public housing prevents the shocking slums that surround so many Asian and Latin American population centres. Vietnamese eateries offer a healthy local diet of vegetables, fresh fish and rice noodles, and locals drive fuel-efficient motorbikes.

But Vietnam has weaknesses. Corruption is rife. Inequality is glaring and widening. People complain about poor-quality social services. And many deeply resent the lack of political freedoms and the monopoly of the Communist party.

So what can Cuba learn from Vietnam? The government could relax the constraints it puts on entrepreneurs. President Raúl Castro could transform his words of welcome to foreign investment into rapid authorisations of tangible capital projects. State-owned firms could partner with domestic and international businesses.

As Vietnam did, Cuba could quickly shift from being a large net importer to a net exporter of agriculture and fisheries. It must allow farmers to earn healthy profits, while creating distribution networks that supply essential inputs and that market foodstuffs at home and abroad.

Cuba has the requisite resources — natural and human — and the location to create a balanced economy. It has fertile soil. Capable scientists have begun building a biotech cluster and the many computer engineers await opportunities that will come with global interconnectedness. The island could again become a shipping and logistics hub. And exotic Cuba could draw a variety of tourists, offering urban culture, eco-resorts, maritime sports, as well as traditional sun and surf.

If Cuban cities are to preserve their charm and liveability, urban planners must be empowered to preserve public spaces and ensure plentiful affordable housing and attractive public transport. Already, the brilliant if slow-paced renewal of Havana’s Old City is a promising precedent.

Avoiding the pitfalls of corruption and inequality will be difficult. But Cuba has advantages: a well-educated and politically aware middle class will probably demand better governance once it has internet connections and social media. With a western legal tradition, Cuba may be more open to monitoring by corporate auditors and non-profit watchdogs.

As it evolves into a more open and market-driven economy, Cuba can improve upon Vietnam’s experience.

As Cuba enlarges its narrow socialist wage differentials, inequalities will grow. But socialist mores run deep and racial and gender divides have narrowed. Debates about market efficiency and equality can be heard in seminar rooms and on city streets. With its superior social services, Cuba has another edge. But its universal education and healthcare facilities have deteriorated and only a more vibrant economy can generate the resources that high-quality services require.

Vietnam’s Communist party can survive in an authoritarian Asia, but can a one-party state endure in the democratic Caribbean? Only time will tell, but even in Vietnam, economic pluralism has opened space for a more tolerant and evolving political system.

As it evolves into a more open and market-driven economy, Cuba can improve upon Vietnam’s experience. Cubans can study Vietnam’s mixed and diversified economy, while eschewing rampant corruption and offensive inequalities and conserving impressive social achievements.

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Running repairs: state experiments with co-operative business model

Reforms From garages and restaurants to dealers in exotic birds, co-ops are growing. By *Marc Frank*

Early on a sunny Sunday morning in Havana, few passers-by or police are around to witness the two men at work. They emerge from the back of a state-run restaurant with cases of beer that they carry to a private restaurant two doors away.

They return for a second load of crates, soft drinks this time, and then back again for some bottled water.

Within a year this scene, at least at this restaurant, may not be repeated. That is because it is one of 300 state-run Havana restaurants slated to become a co-operative, run and owned by its workers — a move that, in theory, will mean staff will not steal from themselves.

But the move also means that the private restaurant the two men were supplying will have to look elsewhere for its stolen beverages, or purchase them from state retail outlets at a minimum 240 per cent mark-up — a potentially crushing blow for its business model.

Both of these changes capture the essence of the Cuban government’s latest attitude to non-state businesses.

In May, for example, tourism minister Manuel Marrero publicly praised the private sector for its “authentic Cuban cuisine and hospitality” and said the ministry was linking up with restaurants and caterers, landscapers and farmers.

The statement would have been unthinkable a few years ago and is a strong indication that the government will not backtrack on economic reforms.

But, while the Communist party has created more space for non-state business, it is clear that it also wants state-sanctioned co-operatives to dominate the secondary economy rather than

private sector entrepreneurs. Almost 500,000 Cubans are registered as self-employed workers, although the vast majority simply ply their skills as small-scale freelancers.

It is a key difference between Cuba and Asian communist societies, such as China or Vietnam, that have undergone economic transition by prioritising market forces and private enterprise.

Co-ops are preferable to other non-state solutions, says economy minister and politburo member Marino Murillo, who is in charge of the economic reforms. “They are a more social form of production.”

Some of the co-ops form spontaneously, although most are fashioned from small or medium state businesses that rent state premises. Examples include construction co-operatives, contractors and tradesmen who are winning state contracts for everything from hospital repairs to public housing construction.

“The construction co-operative La Concordia . . . has become one of those preferred to carry out repairs and maintenance in the public health sector . . . winning contracts to work on hospitals, clinics and homes for the elderly,” a National Information Agency dispatch recently stated.

State-run Radio Reloj also recently reported that Holguin University in eastern Cuba was contracting out to “90 actors in the non-state sector”. The University’s dean justified the move, saying: “when a pipe breaks, I can’t wait around to get it fixed”.

His statement was a thinly veiled criticism of the inefficient state sector. But the change does not signify a whole-hearted embrace of the private sector,



Smoothed over: fixing a soviet-made Lada at a Havana garage co-operative

Reuters

as co-operatives will be favoured over private businesses with tax breaks, access to wholesale supplies and subsidies in exchange for low prices.

A transport co-operative in Havana now has more than 50 minibuses and 100 members. It charges 5 pesos a ride; overcrowded public buses charge 20 centavos, while private taxis from 10 to 20 pesos.

Then there are Havana’s restaurant co-ops. A handful were ordered to become co-operatives a year ago in a pilot now set to become generalised, according to a mid-level Havana official who asked not to be identified. He says they discovered the co-ops could not survive without access to wholesale supplies, even though private restaurants do (often by resorting to the black market).

“We are setting up six wholesale locations in Havana for the new co-operatives,” he says, adding they were not

open to private restaurants. “If the manager [often the current state administrator] is ambitious, creative and energetic the co-operative can work. But if he or she is stuck in their old state ways, they don’t and we have to intervene.”

About 500 non-farm co-ops operate in Cuba, from restaurants and cafés to wholesale and retail produce markets, clothing and furniture manufacturers, a shrimp farm, body shops, recycling operations, computing services, beauty salons, night-clubs and even dealers in exotic birds.

They generally perform better than state firms and members earn more, despite heavy taxes, a state monopoly on foreign trade and a generally dysfunctional soviet-style economy.

But economists point out that in a land where politics often trumps economics, the co-ops’ relative success poses a question: would private businesses perform better still?

Government likely to bring an end to dual currency system

Money

The change would be part of reforms to remove price distortions, says *Marc Frank*

Cuba is likely to eliminate its dual currency system by the end of this year in a first step to simplifying a multiple exchange system that investors view as a serious obstacle to business.

Cuba currently operates two currencies: the peso (CUP), which largely circulates in the domestic economy, and the so-called convertible peso (CUC). Residents and tourists can purchase CUCs at government exchange offices at a rate of one for 25 CUP (\$0.04). State and foreign companies must exchange CUCs at the official one-to-one rate. Neither currency is convertible outside the island.

“It is my understanding that the CUC will be removed from circulation before the next Communist party congress in April,” says a Cuban economist with knowledge of reform efforts.

The move would continue President Raúl Castro’s efforts to introduce market elements and remove price distortions, and improve accounting transparency and the efficiency of state companies.

The economist adds that the currency reform was one of more than 300 reforms adopted at the last party congress, “and Raúl wants them all done by then [April]”.

In a country where the state controls more than 75 per cent of the economy and most wages and local goods are priced in CUP, the CUC is used in tourism, to price imports such as gasoline, and also in upscale eateries and stores.

Until recently, the currencies operated separately, with CUC used by those



Ending? A Cuban holds CUP and CUC

with access to foreign exchange, or who changed CUP for CUC to shop in better-stocked stores. But there are signs of convergence. Many previously CUC-only outlets now accept either. At the same time, a new system of CUP pricing and accounting is being rolled out.

Bigger CUP notes, ranging from 200 to

1,000 pesos, went into circulation this year, and anyone can go to state-run CUC stores and buy a fridge for 1,000 CUCS or the equivalent 25,000 CUPs.

The prospect of reform has unsettled Cubans since the announcement in October 2013 of plans to do away with the dual system. Better-off Cubans have turned to other currencies.

“It is all funny money, only the dollar or euro are safe,” says the owner of a private Havana restaurant. “I change what I can and send it out of the country.”

There has been talk of return to a single currency since Cuba legalised the dollar in 1994 and let the CUC circulate alongside the peso. At the time, the dollar traded at 150 pesos on the black market, compared with seven in 1989.

While unifying the currency — dubbed “day zero” — is a step forward, it is a far cry from full convertibility, which typically requires the backing of large

hard currency reserves, often supported by International Monetary Fund loans.

Cuba is not a member of the IMF. Nor does it report its holdings of foreign currency, but the Economist Intelligence Unit estimates it has \$11bn of reserves against a forecast 2015 current account deficit of £524m as of May 20.

Economists say currency unification, by itself, ignores the real issue: a devaluation of the official exchange rate of one CUP to the dollar, in effect since 1959 and used by many state companies.

“A real monetary reform implies a significant devaluation of the CUP exchange rate,” says Cuban economist and monetary specialist Pavel Vidal, of Javeriana de Cali University in Colombia. “This would change the financial situation of state companies — some of which would fold — improve competitiveness of the sectors operating within the global economy and promote more

transparency in financial accounts.”

Mr Castro says there will be no shock therapy. Central bank officials have told foreign businesspeople that devaluation will proceed cautiously and only in tandem with a strengthening economy.

For now, the government will continue to tinker in the hope of improving the trade balance, stimulating local production and paying workers more.

For example, the state-run sugar monopoly receives 1,000 CUP, instead of 100 CUP, for every \$100 of sugar exports, letting it invest and pay workers more. In the Mariel special zone (see page 3), the state will pay workers 10 CUP for each \$1 foreign business pay their employees, instead of 1 CUP.

The state-run tourism industry also began buying food direct from farmers in 2013, instead of via state distributors or imports. Hotels now change one CUC per 10 CUP to buy local produce.