

**Towards Economic Normalization with Cuba: A Roadmap for US Policymakers  
Statement for United States International Trade Commission hearing on No. 332-552  
“Overview of Cuban Imports of Goods and Services and Effects of U.S. Restrictions”**

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We would like to thank Chair Broadbent and the Members of the United States International Trade Commission for the opportunity to present this testimony in connection with your investigation of Cuban Imports of Goods and Services and Effects of U.S. Restrictions.

We are researchers at the Peterson Institute for International Economics, a private nonpartisan nonprofit institution for rigorous, intellectually open, and in-depth study and discussion of international economic policy whose purpose is to identify and analyze important issues to make globalization beneficial and sustainable for the people of the United States and the world. Along with our colleague, Gary Hufbauer, we authored a book entitled *Economic Normalization with Cuba: A Roadmap for US Policymakers*, which will serve as a base for our discussion.

## **I. Introduction and Summary**

A half century of separation has diminished commerce between the United States and Cuba to a trickle. Recent policy changes, in both Cuba and the United States, open a reasonable possibility that this could change in the near future. Our view is that full economic engagement with Cuba would be to the benefit of both economies. That said, a number of reciprocal steps will be critical to ensure the right transition and equal footing in each other’s markets. The new US regulations announced on December 17, 2014 are important steps that will set the stage for more open trade and investment relations. But it is important to note that Cuba still faces its own serious economic challenges. One of the most pressing is its transition from a dual currency system, that will guide and potentially constrain the pace and scope of bilateral economic engagement.

## **II. The Evolution of US-Cuba Trade and Investment Relations**

Largely as a result of continued trade restrictions, the United States is currently Cuba’s eighth largest supplier of imports as of 2014. US exports to Cuba have faced stagnant if not negative growth in recent years. Over the past five years, US merchandise exports to Cuba, mostly



foodstuffs, have generally ranged between \$330 million and \$510 million, annually; US imports of Cuban goods are practically zero.

In 2014, Venezuela (\$5 billion), the European Union (\$2 billion), and China (\$1 billion) were the leading sources of Cuban merchandise imports, collectively accounting for 70% of total Cuban imports; while Canada (\$508 million), the European Union (\$503 million), Venezuela (\$408 million), and China (\$303 million) were the leading export destinations for Cuban goods, collectively accounting for 65% of total Cuban exports.<sup>1</sup>

What might US consumers expect to see once opening of trade is in place? In terms of goods, Canada imports copper and aluminum scrap, cigars, rum, and frozen lobsters from Cuba; the EU's imports are highly concentrated in petroleum, as well as cane sugar, cigars and rum. WTO statistics suggest that of the \$18 billion of Cuban goods and services exports, nearly 70% is comprised of services; and of the \$17 billion of Cuban imports, more than 85% is comprised of goods. Further opening means significant opportunities for Cuba's service economy.<sup>2</sup>

Using gravity model analysis, Hufbauer and Kotschwar (2014) estimate that under normalized economic relations, US exports of goods and services to Cuba could reach \$6 billion per year, while Cuban exports to the United States could reach \$7 billion. More specifically, these figures break down to US merchandise exports of \$4 billion annually, comparable to US exports to the Dominican Republic (with \$8 billion in 2014) or El Salvador (with \$3 billion in 2014). Cuban merchandise exports to the United States could reach \$6 billion annually, somewhat greater than exports from the DR (\$4 billion) or El Salvador (\$3 billion). There is no recorded services trade between the United States and Cuba and accordingly, the estimated potential gains would start from a small baseline: \$2 billion US exports to Cuba and \$1 billion Cuban services exports to the United States.

Global foreign direct investment (FDI) stock in Cuba was roughly \$427 million in 2011 based on the latest reported UNCTAD statistics, while the reported value of greenfield FDI projects was \$195 million in 2013, continuing a significant downward trend from \$1.6 billion in 2010. Relative to Cuba's peers, global FDI stock in Cuba is minimal, while the US stock is virtually zero. Of the nearly 250 joint ventures in Cuba, Spain, Italy, Canada, and Venezuela are among the major investors, with tourism, oil and energy, and agro-food the top targeted sectors for foreign investment.

Simple country comparisons provide a rough baseline for the potential scope of US and world FDI in Cuba. With normalization, Cuba could attract at least similar global FDI stock as the Dominican Republic or \$17 billion, and possibly \$2 billion from the United States. By comparison, in 2013, US FDI stock in the Dominican Republic was \$1.3 billion, about \$1 billion in Costa Rica, and \$2.9 billion in El Salvador.

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<sup>1</sup> Trade figures from IMF Direction of Trade Statistics.

<sup>2</sup> WTO Cuba trade profile, available at <http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Country=CU>.



### III. New Regulations as a Small Stepping Stone Toward Deeper Economic Integration

The new US regulations have expanded opportunities for the exchange of people, trade in goods and services, and finance. These come at a time of complementary, albeit incremental, changes within Cuba under President Raul Castro, who has introduced economic reform measures including allowing Cubans to buy and sell property, lifting restrictions on small-scale private economic activity, allowing a select number (at last count just over 200) of self-employment activities (the *cuentapropistas*, which as of January 2015 numbered just over 480,000), and permitting more freedom of movement of Cubans within and outside the country.

Relaxed US travel restrictions should facilitate American travel to Cuba within the 12 categories no longer subject to a specific license. Beyond facilitating important cultural exchange this will entail expected benefits for the Cuban economy with the lifting of the *per diem* dollar limit, permission to import \$400 of goods per person, and legal use of bank cards in Cuba. Travel for tourism remains excluded for US travelers. Tourists to Cuba from all countries number 3 million annually, according to the Caribbean Tourism Organization. By contrast, approximately 7 million US tourists traveled to the Caribbean in 2013, with average travel expenditures (excluding airfare) of \$1,000 per person; potential US tourists to Cuba lost to other Caribbean destinations could be roughly 1 million—for context 900,000 Canadians visited Cuba in 2013.

And now select imports of Cuban goods and services are also permitted, as produced by *cuentapropistas*, the small group of self-employed entrepreneurs in Cuba. However, an important backdrop to these changes is that Cuba still retains state control of distribution.

The new US regulations permit micro-financing, business training, and exports of tools and equipment for private businesses and farmers in Cuba. These should allow US companies to take advantage of commercial opportunities in construction, transportation, tourism, agriculture. While the majority of the US regulations are designed to help support the nascent private sector in Cuba, several intend to bolster the Cuban market for US agricultural products. Some key procedural requirements have limited the expansion of trade, including that Cuban purchases be made via cash-in-hand payments and handled through third-party banks, and that the logistics and distribution of US imports be handled by the Cuban state-trading entity *Alimport*.

US agriculture remains an important target for increased trade. Cuba is a net food importer and lucrative market for US companies. Cuba's top three imports from Canada are wheat, legumes and maize, followed by chemicals, fertilizers and computers, which represent more long-term opportunities for US exporters. US agricultural exports to Cuba averaged \$360 million in recent years, down from a peak of \$700 million in 2008, and the US share of total Cuban imports decreased from 42% in 2007 to about 20%. The US Department of Agriculture projects that once export restrictions are fully removed, US agricultural sales could reach \$1 billion.



The new regulations also give special attention to expanding US exports of telecommunication and internet-related goods and services. The low connectivity, high prices, restrictions on use, and prevalent surveillance, coupled with the lag in telecommunications infrastructure has led Cuba to have one of the lowest Internet and mobile phone penetration rates in the region. The new US regulations would be just a start, allowing US companies to establish commercial telecommunications services in Cuba and allowing US exports of consumer communications devices, related software, hardware, and services.

#### **IV. Challenges for the New Relationship**

In our book *Economic Normalization with Cuba: A Roadmap for US Policymakers*, we argue that while full economic engagement with Cuba is important, the sequencing is equally important. Simply lifting the embargo will not be enough, but a careful and reciprocal approach should encourage Cuba to build solid economic and political institutions. Toward this end, there are three likely scenarios: (1) gradualist normalization following the example of China and Vietnam; (2) big bang with monopoly capitalism following the example of Russia; and (3) big bang with market capitalism following the example of Poland—perhaps the easiest for US-Cuba relations, but also the least likely.

Moving forward, the policy challenge for the United States, is how new regulations should be designed to help avoid scenario two and pave the way for greater competition in the Cuban economy and a better chance for US companies.

Cuba technically has no border barriers to US trade and investment. It is easy to claim that the embargo is the only barrier to full economic relations with the United States. This assertion is formally true, but once opened to this large commercial partner, powerful state-owned industries will have a vested interest in demanding disguised protection from outside competition. Such a move by these interests would hurt not only US businesses but Cuban consumers, who would pay higher prices for goods and services, and new Cuban entrepreneurs, who would be frozen out. Entrenched interests from other countries, who now enjoy a privileged position, protected from US competition, may also lobby for special treatment.

Cuba faces serious challenges to improving its investment climate from property rights to labor practices to physical infrastructure. To invest in Cuba, multinational companies must generally form joint ventures with state enterprises, employ Cubans vetted by the government, and are often subject to prices controls and other state interference.

Several challenges remain, even in sectors favored by the new changes. US expansion into Cuba's information technology (IT) sector looks promising—but it remains unclear how receptive Cuba will be to US sales of telecom equipment and services. There is precedent for past failed attempts at partnerships between the United States and Cuba; moreover, Cuba retains a strong state hold on telecommunications. To be sure, these concerns are also part of a broader discourse on the investment climate at large in Cuba.



On the US side, Helms Burton still remains in force, and while more US companies can now sell to Cuba, under specific conditions, the ban on financing remains in place. On the Cuban side, while the new US regulations have moved forward quickly, the key factor is how Cuba will move forward with its implementation and whether additional barriers will be placed on the private sector.

A key message is that this is an opportunity for US policymakers to orient the new engagement towards the creation of strong market-oriented institutions that will help benefit Cuban private entrepreneurs, consumers, and US businesses. With the right framework, the United States can offer a wide range of goods and services, including full liberalization of tourism, along with technical and financial assistance. In return, Cuba can ensure national treatment for US goods, services and investment, and accord US firms the same treatment already offered to European, Canadian, and Chinese firms.



**Annex 1**

# **Economic Normalization with Cuba: A Roadmap for US Policymakers**

**Barbara Kotschwar and Cathleen Cimino**

**United States International Trade Commission  
Hearing on No. 332-552 “Overview of Cuban Imports of  
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# A half century of separation

- Cuba-US trade is down to a trickle: US is 8<sup>th</sup> supplier of goods to Cuba, no imports
- Full engagement with Cuba would benefit both economies
- A number of reciprocal steps is necessary to ensure the right transition and equal footing in each others' markets
- The Dec. 17<sup>th</sup> regulations mark steps towards to set the state towards this end



# US-Cuba Trade: Starting from a Low Base

**Table 6.2 Actual versus potential US-Cuba merchandise trade based on gravity model estimates**

US-Cuba merchandise trade (actuals and within normalization)				US-Cuba merchandise trade (with US-Cuba FTA)			
Actual trade (US\$ millions)		Potential trade (US\$ millions)		Trade shortfall (Percent)		Potential trade (US\$ millions)	
US exports to Cuba	Cuba exports to US	US exports to Cuba	Cuba exports to US	US exports to Cuba	Cuba exports to US	US exports to Cuba	Cuba exports to US
2005	361	0	2,982	3,972	87.9	5,599	7,459
2006	348	0	3,398	4,527	89.8	6,381	8,500
2007	447	0	3,722	4,958	88.0	6,988	9,310
2008	718	0	3,918	5,219	81.7	7,356	9,799
2009	533	0	3,924	5,228	86.4	7,368	9,816
2010	370	0	4,117	5,485	91.0	7,738	10,298
2011	352	0	4,322	5,757	91.9	8,114	10,809

**Table 6.3 Actual versus potential US-Cuba services trade based on gravity model estimates**

US-Cuba trade in services (actuals and with normalization)				US-Cuba services trade (with a US-Cuba FTA)			
Actual trade (US\$ millions)		Potential trade (US\$ millions)		Trade shortfall (Percent)		Potential trade (US\$ millions)	
US exports to Cuba	Cuba exports to US	US exports to Cuba	Cuba exports to US	US exports to Cuba	Cuba exports to US	US exports to Cuba	Cuba exports to US
2005	0	0	1,054	608	100.0	1,440	831
2006	0	0	1,219	703	100.0	1,666	961
2007	0	0	1,347	777	100.0	1,840	1,061
2008	0	0	1,422	820	100.0	1,942	1,120
2009	0	0	1,418	818	100.0	1,938	1,118
2010	0	0	1,495	862	100.0	2,042	1,178
2011	0	0	1,574	908	100.0	2,151	1,240

FTA = free trade agreement

Source: Hufbauer and Kotschwar (2014).

**Gravity model estimates indicate that under normalized economic relations, US exports of goods and services to Cuba could reach \$6 billion per year, while Cuban exports to the United States could reach \$7 billion.**



# New Regulations as Small Stepping Stones Toward Deeper Economic Integration

- Sales of goods to *cuentapropistas*
- Micro-financing, business training, and exports of tools and equipment for private businesses and farmers in Cuba
- Facilitation of new opportunities for construction, transportation, tourism, agriculture
- Internet/telecom
  - New US regulations a start, allowing establishment of commercial telecom services and exports of consumer communications devices, related software, hardware, and services.



# Stepping stones on the Cuban side

## Raul Castro: *sin prisa pero sin pausa*

- Cubans can now sell or rent property
- 200+ allowed private sector activities
- Travel ban lifted
- New foreign direct investment (FDI) law in 2014:  
wish list of 246 projects
- Dual currency system: Government is preparing  
conditions for unification



# Challenges for the new relationship

While full economic engagement with Cuba is important, the sequencing is equally important. Simply lifting the embargo will not be enough, but a careful and **reciprocal** approach should encourage Cuba to build solid economic and political institutions. **There are 3 likely scenarios:**

## 1. Big Bang with Market Capitalism

- Poland and Baltic states
- Easiest for US-Cuba relations
- But, least likely

## 2. Big Bang with Monopoly Capitalism

- Russia and Ukraine
- Capitalism quickly replaces state ownership
- Monopolies/oligopolies capture economy

## 3. Gradualist Normalization

- China and Vietnam
- Step by step reforms
- Significant overlap between political and economic normalization

**What can US negotiators do to help avoid scenario 2 and help scenario 3 move towards scenario 1? What steps can be taken to pave the way for greater competition in the Cuban economy (and better chances for US companies)?**



# Continued Obstacles: Is the US Embargo the Real Blockade?

- Cuba has no restrictions on US goods, services or investment – **yet.**
  - But once open to competition from the US, existing state-owned enterprises will have a vested interest in demanding protection
  - Foreign companies with a privileged position may also lobby for special treatment
- Institutional barriers to taking advantage of changes in regulations
  - Cuban government monopoly on imports and exports – no mechanism yet for private actors to trade;
  - Will Cuban government allow US sales of telecom equipment and services?
  - Most self-employment is low-tech, low-skill;



# Cuba's Potential for US FDI

- Looking to the future, the investment climate is not always welcoming:
  - Cuba's inward FDI stock low compared to its neighbors.
  - Could Cuba attract as much FDI stock as the Dominican Republic: \$17 billion from the world and \$2 billion from the United States?

Cuba		Dominican Republic		Costa Rica	
Population	Inward FDI stock	Population	Inward FDI stock	Population	Inward FDI stock
11.2 million	\$500 million	10.2 million	\$17 billion	4.8 million	\$16 billion

Sources: World Bank's WDI and UNCTAD World Investment Report.



# Cuba's Potential for US FDI

	Costa Rica	Dominican Republic	Cuba
Institutions	4.3	3.3	?
Infrastructure	4.1	3.3	?
Macroeconomic environment	4.4	4.4	?
Health and primary education	6.1	5.0	?
Higher education and training	5.0	3.7	?
Goods market efficiency	4.5	4.2	?
Labor market efficiency	4.3	3.8	?
Financial market development	3.7	3.7	?
Technological readiness	4.8	3.5	?
Business sophistication	4.5	3.9	?
Innovation	3.8	3.0	?

Source: World Economic Forum.



# Conclusions

- **US officials should take advantage of the current incomplete thaw to set the groundwork for reciprocal economic negotiations and the creation of strong market-oriented institutions that will help benefit Cuban private entrepreneurs, consumers, and US businesses.**
- **With the right framework**, the United States can offer a wide range of goods and services, including full liberalization of tourism, along with technical and financial assistance. In return, **Cuba can ensure national treatment for US goods, services and investment**, and accord US firms the same treatment already offered to European, Canadian, and Chinese firms.
- **Not doing so could cause two unfortunate results:**
  - Cuba's economic normalization will proceed at a slower pace, accompanied by greater favoritism to vested interests and greater corruption of public officials.
  - US firms and citizens will be pushed to the back of the line for commercial opportunities in Cuba.



