

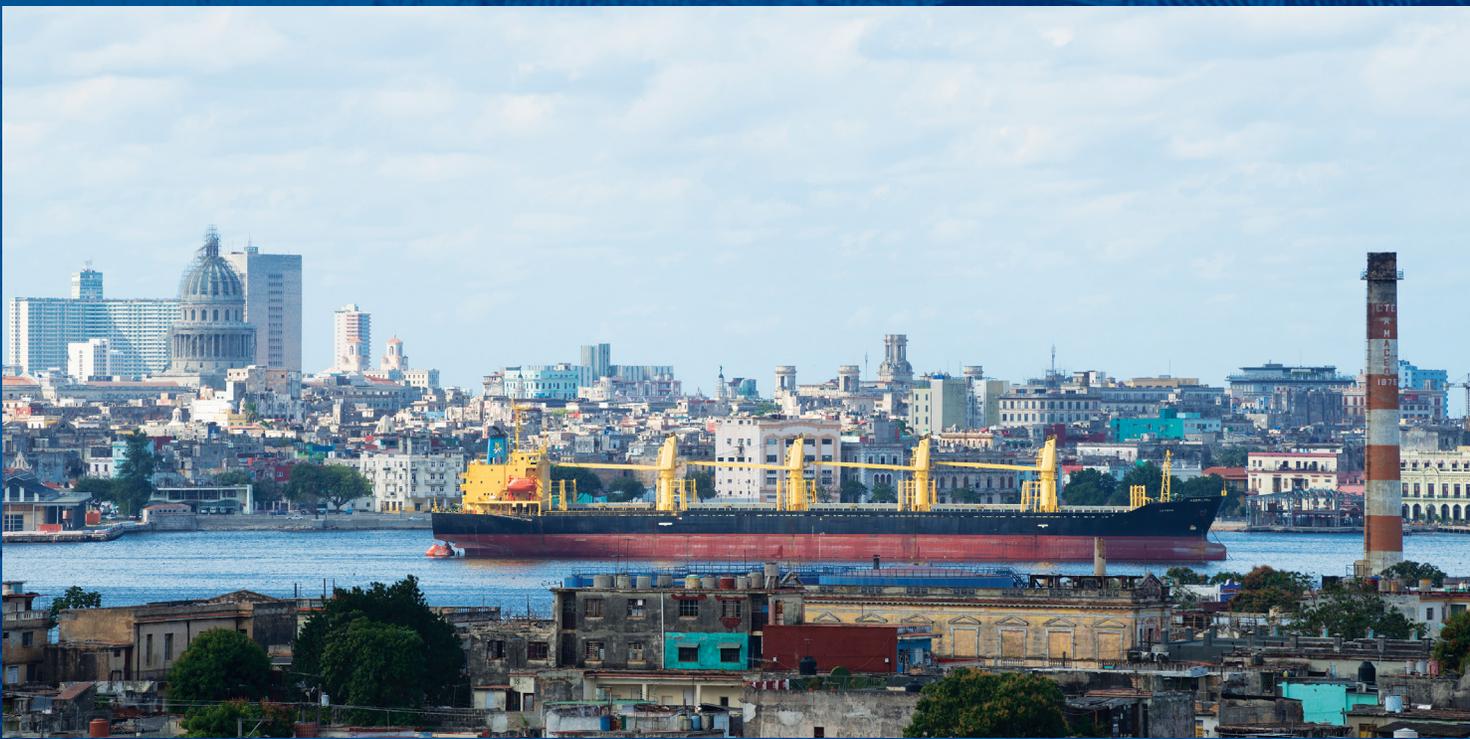


**Atlantic Council**

ADRIENNE ARSHT  
LATIN AMERICA CENTER

# Cuba's Economic Reintegration

## Begin with the International Financial Institutions



The Right Step for Improving  
the Lives of Cuba's Citizens

By Pavel Vidal and Scott Brown



# Atlantic Council

## ADRIENNE ARSHT LATIN AMERICA CENTER

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The Atlantic Council's Adrienne Arsht Latin America Center is dedicated to broadening awareness of the transformational political, economic, and social changes throughout Latin America. It is focused on bringing in new political, corporate, civil society, and academic leaders to change the fundamental nature of discussions on Latin America and to develop new ideas and innovative policy recommendations that highlight the region's potential as a strategic and economic partner for Europe, the United States, and beyond. The nonpartisan Arsht Center began operations in October 2013.

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1030 15th Street NW, 12th Floor  
Washington, DC 20005

Cover photo credit: Joel Carillet/iStock.

ISBN: 978-1-61977-988-4

July 2015

### **Acknowledgements**

This report was produced with the extraordinary help of a number of Atlantic Council colleagues. In the Adrienne Arsht Latin America Center, Rachel DeLevie-Orey, assistant director, passionately helps to guide our Cuba portfolio with her encyclopedia of knowledge and insight on the island; she saw this report through from conceptualization to publication. Carmen Muñoz, program assistant, yet again provided invaluable editing and proofreading as well as overall strategic guidance. Maria Fernanda Pérez, program assistant, stepped in to help the team with the English-language translation of the original report. In the communications department, we would like to specifically thank Nonna Gorilovskaya, associate editor, and Romain Warnault, publications and graphic design coordinator, for their endless flexibility and hard work. Our consultant, Donald Partyka, designed yet another excellent report for the Arsht Center.

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# Foreword

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Last year, the Adrienne Arsht Latin America Center released a nationwide poll that found widespread support for engagement with Cuba. It called attention to a radical shift in American public opinion and helped give President Barack Obama the political proof he needed to change five decades of failed policy.

Since then, seismic changes in US-Cuba relations have reshaped the landscape of each country's interactions with Latin America and the global community. Ongoing negotiations and new legislation continue to dismantle this relic of Cold War policy. Such progress is applauded across the world.

US policy toward the island is in transition. In light of the President's executive orders in December, we are now seeing movement in Congress. Support is growing for removal of the travel ban. Trade, telecommunications, finance, and compensation for nationalized property will all be part of the agenda, as will human rights—a key point of contention given the lack of democratic freedoms for the Cuban people.

Cuba is also in a historic period of transition. President Raúl Castro plans to step down in 2018. To jumpstart Cuba's economy, he will need to accelerate the fiscal and monetary reforms started in 2008. International financial institutions (IFIs), including the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank (IDB), hold the key to easing Cuba through a tough transition to a more stable economic model that will better the lives of its people. Cuba's reintegration will inevitably spur unprecedented economic change. As this paper discusses, this transformation is precisely what occurred in previously closed economies that chose

to rejoin the global economy.

But significant obstacles exist to Cuban admission to the IFIs. A series of US laws require US representatives to the IFIs to oppose such admission as well as any multilateral funding for Cuba. Castro himself has been an outspoken critic of the IFIs, long-seen by the Cuban government as agents of imperialism and neoliberalism. Still, signs point to the potential of a new mindset around rejoining these institutions, with Castro greatly diminishing his vitriol against the IFIs in recent years.

US policymakers should recognize the tremendous value of Cuban membership in the IFIs for bilateral relations with Cuba and the United States' international position. The United States is the only major country that continues to impose economic sanctions against Cuba, a point that has consistently hindered its image and stature abroad. Supporting Cuban participation in the IFIs, or even the less politically-toxic option of simply avoiding vocal opposition, will do much more than just strengthen partnerships with democratic allies around the globe. IFI monies and technical advice to modernize sectors such as agriculture, infrastructure, banking, and tourism will be critical to renewing the island's economic vibrancy and creating new possibilities for Cubans to improve their lives.

The Adrienne Arsht Latin America Center is dedicated to facilitating US-Cuban rapprochement. A new era will pay dividends for the United States' interests in the hemisphere and beyond. With the publication of this report, we hope to provide a tangible and achievable method for advancing the process of reengagement between these two countries as well as the necessary reintegration of Cuba into global economic systems.

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# Table of Contents

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- 3 **Executive Summary**
- 5 **Reforms Are Here... and More Are Coming**
- 6 **Why Join the IFIs?**
  - An Economy with Promise but Needing Help
  - How the IFIs Can Assist
  - A Helping Hand in Tackling Pending Reforms
  - Challenges for the Cuban Government
  - How Can Cuba Gain Membership?
- 11 **Global Experiences**
  - Albania's Entry into the Global Financial System
  - Sidebar: The Vietnamese Experience
- 16 **Why Should the United States Support Cuba's Reintegration?**
  - What Is the Best Way to Help the Cuban People?
- 18 **Recommendations for Cuba, the United States, and the International Financial Institutions**
- 20 **Endnotes**
- 21 **About the Authors**

# Executive Summary

**T**he new US policy toward Cuba comes at a critical moment, with its impact reaching far beyond the Florida Straits. Since President Obama's historic announcement in December 2014, Havana has welcomed the Presidents of France and Turkey, the Foreign Ministers of Japan and the Netherlands, the Director of Diplomacy for the European Union, the Governor of New York, and a host of other policymakers and entrepreneurs from the United States. Pope Francis is scheduled to visit in September.

Engagement will be critical to buttressing the government's appetite for reform. After twenty-five years of post-Soviet adjustment and patchy results from limited reforms, a consensus exists that the economic system and old institutions require a fundamental overhaul. The Cuban government is cognizant of the imperative to allow the "nonstate," or private sector, to grow. It is the only way to slim down the public sector without massive unemployment.

Now that Cuba has caught the eye of foreign investors and the international community, it is a good time to reignite discussion on Cuba's reintegration into the global economy. As with so many other countries before, the critical first step will be to regain access to the international financial institutions (IFIs), with a particular focus on the



**President Barack Obama talks with President Raúl Castro on December 16, 2014, opening new communication one day before historic policy changes.**

International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank (IDB).

Accession would serve the interests of Cuba and its citizens, the United States, and the international community. In Cuba, the process of economic reform is at a pivotal moment, and more progress is needed to lift the economy on to a new growth trajectory before President Raúl Castro is to step down in 2018. Accession will require adjustments: improving data and transparency, aggressively working to unify the two currencies, and shifting official attitudes. But in the context of the new relationship with the United States, these should not be difficult.

The experiences of other former communist countries can provide lessons for Cuba. Albania,



THOMAS DOOLEY/FLICKR

**Cuba is one of only eight countries in the world that are not members of the IMF, headed by Christine Lagarde (pictured above).**

which joined the IMF in October 1991, has some interesting parallels. Albania's first loan from the Fund, under a stand-by arrangement, was approved in August 1992, and its reengagement with the global financial system and policy reforms produced significant improvements in the standard of living. Vietnam offers another positive example, with access to IFI support coming after a period of initial reform. In both countries everything from GDP to life expectancy improved. These universal benefits are compelling factors for Cuba.

For the international community, Cuba's accession is long overdue. Still, in the United States, agreement to Cuban accession could face objections. However, those objections rest on discredited assumptions that sanctions can bring political change and that international support will help only the government and not the people of Cuba. US backing of Cuban membership in the IFIs would be consistent with the new policy of helping to support economic reform. This is a

unique opportunity to stimulate further transformations in Cuba.

Three possible approaches exist for Cuba to join the IFIs. The first would involve a gradual process of confidence-building between the IFIs and the Cuban authorities, with no initial commitment or date for membership. The second would be a more direct and immediate path, beginning with a Cuban decision to apply for membership. The third would be for President Obama to take the initiative by making a public statement of support for Cuba's accession to the IFIs, claiming his constitutional prerogative to define the direction of US foreign policy—much like the leadership by President George H. W. Bush in advocating for Russian engagement and membership in the IMF in 1991-1992.

This report argues that a series of steps can be taken now—by Cuba, the United States, and the international community—to pave the way for Cuba to be welcomed back as a full and active member of the international financial institutions.

# Reforms Are Here... and More Are Coming

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**S**ince 2008, when Raúl Castro took office as President, Cuban society has been changing. The economy is undergoing market liberalizations and macroeconomic adjustments. While the process may be at an early stage, reforms have already tripled the number of private and cooperative businesses, state lands have been distributed to farmers, the purchase and sale of vehicles and houses is now permitted, and consumer options (including hotels and cell phones) continue to grow.

From a macroeconomic perspective, the government has advanced toward reestablishing fiscal and balance of payments equilibriums, maintained low inflation, and promoted a more rational public expenditure. Cuba is now diligently fulfilling international financial commitments and making progress in renegotiating its international debts. Raising the level of aggregate investment is a top priority—in fact, it is the primary objective of the strategy for reviving GDP growth.

A seismic shift is underway in two of the fundamental mechanisms long used to exert control over the Cuban people: restrictions on the freedom of movement and economic activity. Cubans no longer need the permission of the state to leave the island—temporarily or permanently—and the expansion

of nonstate activity means that fewer families now depend on the state for their income. Citizens have greater freedom to invest and spend money.

Cuban authorities have also announced an increase in Internet availability, which means greater access to information. Although relaxing restrictions does not mean dismantling them. The Cuban state continues to exert considerable control

over society and the economy through extensive state ownership and command of the main economic activities. Still, the reform process is clearly understood as part of a journey toward a mixed economy.

The process of transformation was confirmed by the VI Congress of the Communist Party in April 2011, when five-year economic policy guidelines were laid out. This five-year period will end in April 2016. The VII Communist

Party Congress will then set out the next stage of the Cuban reform agenda, where ongoing changes are expected to be deepened. Two years later, in 2018, Raúl Castro will end his presidency. These two moments will mark a turning point in Cuban development. Collaboration with international financial institutions could allow the global community to seize this opportunity to support Cuba's economic transformation.

**Collaboration with international financial institutions could allow the global community to support Cuba's economic transformation.**

# Why Join the IFIs?

## An Economy with Promise but Needing Help

Despite a host of reforms introduced since 2008, Cuban economic growth has been weak. From 2008-2014, average annual GDP growth reached only 2.8 percent. While this is close to the Latin American and Caribbean average, it is only around half the originally anticipated 5.1 percent forecast by the Cuban government. Growth in the agricultural and industrial sectors fell particularly short of expectations, with average annual rates of only 0.6 percent and 2.5 percent respectively, while private household consumption registered only 2.6 percent growth—well short of the amount needed to provide the hoped-for, and



**Luis Alberto Moreno, President of the Inter-American Development Bank, has discussed the possible road-map for Cuba to join the IDB.**

long-awaited, improvement in living standards.<sup>1</sup>

Over the past decade, growth has been led by the export of professional (principally medical) services, which have become the primary source of foreign currency income. Cuba's dependence on this activity—tied to its reliance on oil imports from Venezuela under very favorable terms—has become a cause for deep concern in Cuba as the economic and political crisis in Venezuela worsens.

One fundamental problem of the Cuban economic model is its inability to generate sufficient investment. The level of aggregate investment, according to official figures, has languished at around 10 percent of GDP for the past two decades: only half the regional average and less than a quarter of China's rate.

The government has accepted that it needs more foreign investment. In 2014, in the hope of attracting an estimated \$8 billion in new foreign investment, a foreign direct investment law was introduced, a "Special Development Zone" at the upgraded and expanded Mariel port was inaugurated, and a prospectus of proposed projects was published. Although the targets for new contracts have yet to be met, foreign business interest has grown. A major factor in this renewed attention appears to be the rapprochement with the United States.<sup>2</sup>

## How the IFIs Can Assist

The IFIs are in a position to leverage the capacity of the Cuban economy to attract investment and raise the rate of capital formation. Development loans from IFIs would allow Cuba to carry out much-needed improvements to its depleted infrastructure and would reduce the cost

of doing business. Benefits from IFI support include:

- *An international vote of confidence in the Cuban economy.* This would influence attitudes toward Cuba in global financial markets. Reducing country risk perceptions would support greater economic integration, including the possibility of Cuba's inclusion in international companies' global value chains. It would also enable Cuba to gain access to lower interest rates for international financing, easing its balance of payments constraint and therefore enabling stronger economic growth.
- *Access to technical assistance and training.* Cuban entrepreneurs and policymakers would benefit from this assistance and the adoption of international best practices. Agriculture could be modernized. Communications, Internet, and telephony improvements can begin. Enhancement of the tourism sector could also draw on international training, quality standards, and marketing expertise. Still, the banking and financial services sector needs to be strengthened and legitimized before companies can have a serious presence in Cuba.

**IFI support could be particularly important for Cuba as it contemplates the replacement of its dual-currency system.**

### **A Helping Hand in Tackling Pending Reforms**

**T**wo areas of reform will be the focus of the Cuban government in the next few years: reform of state-owned companies and currency unification. Though access to IFIs does not guarantee the success of these reforms, it would certainly help.

The state-owned companies that continue to hold a monopoly over most sectors in the Cuban

economy have already been undergoing deep changes, with new regulations and procedures implemented. But progress on decentralization, reorganization, restructuring, and rationalization has been painfully slow, and technological deficiencies and low productivity continue to impede growth. Through the IFIs, Cuba could have access to research and evaluation in the reform of state enterprises.

The dual currency system remains an enormous burden on the Cuban economy, distorting all decision-making, negatively affecting the management of companies and increasing financial risk. The over-valued official

exchange rate of the Cuban peso, artificially pegged to the American dollar, has warped corporate balance sheets, skewed prices, and reduced competitiveness. Currency unification has been predicted and postponed countless times, contributing to uncertainty on the future value of the exchange rate and inflation levels. But unification is imminent. The result is that—no matter the attractiveness

of foreign investment laws—the dual exchange rate creates a high level of risk for foreign investors.

IFI support could be particularly important for Cuba as it contemplates the replacement of this dual-currency system with a single adjustable exchange rate. There are risks of monetary instability inherent in this process,<sup>3</sup> and Havana might welcome guidance on the design and construction of a monetary and exchange system that establishes both financial stability and contributes to economic growth. The IFIs are well-equipped to support such a process.

## Challenges for the Cuban Government

Cuba has much to gain with a return to the IFIs, and signs of a change in political conditions show that such a move is possible. For decades Cuban leaders demonized these institutions, but recent rhetoric has largely ignored them. This change is consistent with Cuba's efforts to improve its position in the international markets. It suggests that the country's leaders are no longer hostile to the official institutions that regulate those markets, although reservations and criticisms continue.

One major adaptation that Cuba would need to make if it were to contemplate full IFI membership is the preparation of internationally comparable financial data. At the moment, the Cuban Central Bank does not publish the information required for full assessment of its international payments position. The data series that are missing from published sources are:

- International reserves levels;
- Central Bank balance;
- Monetary aggregates for all currencies;
- Greater disaggregation of both the current and financial accounts of the balance of payments;
- Full data on price indices in both currencies;
- Assets and liabilities of the financial system; and
- Details of the composition of external and domestic debt.

Improved data reliability, timeliness, and transparency would reduce risk for foreign investors and lenders, as well as those engaging in trade. It would help the Cuban authorities to achieve their stated objective of attracting investment through open competition, with a level playing field, and moving away from the existing

centralized (and therefore non-transparent and potentially politically-driven) methods of decision-making. This is important not only for the government's finances and investors, but also for long-term competitiveness. Strong standards of accountability will help improve access to international financing as reforms progress.

## How Can Cuba Gain Membership?

Cuba withdrew from membership in the World Bank in 1960, and from the IMF in 1964. It was never a member of the IDB, which was founded in 1959, the year of the Cuban revolution.<sup>4</sup> Today, 188 of the world's 196 countries

are members of the IMF and World Bank, including all the sovereign nations of Latin America and the Caribbean—except Cuba.

Three approaches to Cuba's introduction into the IFIs are possible.

1 The first is the establishment of a gradual process of reconciliation between the IFIs and Cuba, with no date set for eventual membership. It would begin with preliminary exploratory talks,

moving on to technical support and training, and then continue with a process of trust-building until membership becomes the next step. There are precedents for this, as other non-member countries have undertaken protracted discussions before becoming members, and Cuba has also previously held unofficial talks with officials from the IFIs.

2 The second approach is for the Cuban government to formally request membership in the IMF (which would subsequently open the way for World Bank membership) and/or to rejoin the OAS and Inter-American system (the requirement for IDB membership). Cuba has already been invited

**Improved data reliability, timeliness, and transparency would reduce the risk for foreign investors and lenders in Cuba.**

to rejoin the OAS, but up to this point, it has declined. This is in part because the Cubans worry that the United States would try and block this, as with other IFI memberships. Here, too, the United States should find a way to abstain from this vote, thereby allowing Cuban access. This would require a shift in Cuban position from its past policy stance of declining to rejoin, as well as a US policy shift.

For the IMF, endorsement from an existing member country would be needed, and this

cannot technically block Cuban membership to the IMF, World Bank, or IDB as such decisions require a majority vote over which the United States does not have enough voting share to block. The IMF also prefers to take important decisions as much as possible by consensus. However, the issue of US law mandating some type of funding withdrawal would need to be resolved. The implementation of this provision has not been tested, and whether it could be contested in practice remains open for

debate. It is possibly a matter that would end up in court. The third approach for greater IFI engagement (see p. 10) explores this point further.

Three other provisions of US law also inhibit Cuban admission in, or funding from, IFIs. First, the Victims of Trafficking and Violence Protection Act of 2000 ranks countries based on their adherence to anti-human trafficking standards and procedures, and stipulates that the President should instruct the US Executive Directors of IFIs to vote against multilateral loans to Tier 3 countries, deemed to be the worst performers. Cuba is currently listed as a Tier 3 country. This law does

not appear to be an insuperable obstacle, as Cuba's inclusion in the Tier 3 list is based on its failure to report details of its anti-trafficking actions to the US authorities, a legacy of previous hostilities that could be put right under the new conditions. Moreover, the law allows the President discretion to waive these restrictions.

The second of the provisions is Public Law 104-208 (1996), which requires US representatives in multilateral financial institutions to vote against funding to countries that do not have a system of independent civilian audits of military expenditures, which Cuba does not. Again, this would not appear to be an insuperable difficulty now that the two governments are willing to discuss sensitive issues.

Finally, the statutory requirement known as the Gonzalez Amendment (1972) requires that



**The Cuban government's renovation of El Capitolio signals the many potential changes as it seeks to create a new international image.**

country would serve as its advocate throughout the application period. Brazil, a regional power and a trade partner with Cuba, might serve in this capacity.

The problem with this approach is that it would directly confront the obstacles created by US sanctions. But, in examining the provisions of US rules, these obstacles do not appear to be as insurmountable as they might first appear.

The Cuban Liberty and Democratic Solidarity (Libertad) Act of 1996 (known as the Helms-Burton Act) would appear to be the greatest difficulty. The law mandates not only that US representatives in these institutions must vote against Cuban membership but also instructs the United States to withhold funding from any IFI that grants assistance to Cuba (the withholding being equal to the amount of the assistance). The United States



**Bicycle taxis have become a popular source of private income for Cubans in response to the growing tourism sector on the island. Could the IFIs help advance this sector?**

similar to the advocacy role played by President George H. W. Bush in 1991-92 vis-à-vis IMF engagement and membership for Russia and other countries of the former Soviet Union.

Such a move would encounter objections and challenges from supporters of US sanctions against Cuba, although the President would have a strong case. All the laws that instruct US representatives to vote against membership allow an exception for when the President declares a decision to be “in the national interest.”

US representatives in the IFIs oppose proposals for funding to any country that has nationalized or expropriated property previously owned by the US government or private US citizens, until an agreement for proper compensation has been reached. This law is clearly targeted at Cuba. While this might seem to be a major hurdle, the talks now being held as part of the rapprochement will eventually need to address the issue of outstanding claims.

**3** The third option for facilitating IFI engagement is for President Obama to employ his constitutional right to define the guidelines of US foreign policy and make a public statement that the United States does not oppose Cuban membership to the IFIs. This would be

These three approaches are not mutually exclusive and could be adopted in sequence or in parallel. Assuming the interest of both countries, the best course of action might be determined through bilateral negotiations, in which IFI representatives could be invited to participate. The least risky approach would be the first, which allows both the Cuban and US governments to determine how much progress would need to be made before making the more public moves implied by the second and third approaches. If and when the two sides accept that they might have an interest in Cuba's IFI membership, there would seem to be few obstacles to moving ahead on confidence-building work.

JOHN C. BRUCKMAN/FLICKR

# Global Experiences

**C**uba is not the first country to undertake an accession process to the IFIs. Many others have done so with Albania and Vietnam providing two useful examples. Although their conditions differ in important ways from those faced by Cuba, each provides relevant experience from which lessons can be drawn when considering the Cuban process. In both cases, acceding to the IFIs was a significant turning point, in terms of both providing a boost to economic performance and giving support to a process of structural transformation.

## Albania's Entry into the Global Financial System

**C**uba and Albania both emerged as independent states in the early twentieth century, and spent much of the second half of the century under Communist Party rule. In the case of Albania, communists took control after playing a leading role in liberating the country from fascism in 1944 and were finally ousted, amidst crisis, in 1992. In Cuba, the communist government that has been in power since the 1959 revolution proved more durable and flexible, and

remains in place.

Before the winds of change began to blow outside Albania's borders with the "European Spring" of 1989, the Albanian government had isolated itself politically and economically and had embraced self-sufficiency as a central goal of national policy, at great economic cost. After the USSR dissolved in 1991, Albania followed its Eastern European neighbors and newly independent former Soviet republics in joining the IMF, with broad popular support amid widespread expectations that economic reform and linkages with the rest of the world would significantly improve the quality of life.

When Albania joined the IMF in October 1991, it was not only looking for financial support but



**Tirana's Skanderbeg Square has transformed since 1988 as Albania began to enter the global economy.**

also for assistance in designing economic reforms. To meet IMF accession requirements, Albania had to overcome three hurdles: weaknesses in its institutions and statistical base; the lack of familiarity of its government and people with the global financial system; and the need for support from other IMF members for its application.

### **IFI Support Critical for Albania's Transition**

**P**rotracted efforts were needed to deal with Albania's institutional deficiencies, knowledge gaps, and weak statistical base. The IMF, the World Bank, the European Union (EU), and the US government all became strong partners in providing training and advice, with the IMF alone sending over seventy-five technical assistance missions to Tirana during 1991-2000. Technical assistance and training by Western institutions covered a number of areas: fiscal, monetary, and exchange rate policies; public financial reform; bank supervision; legal foundations of a market

economy; external debt and foreign exchange reserve management; economic statistics; public enterprise reform; and a range of sector development strategies.

The intensity and modalities of technical assistance and training varied with the topic. For instance, in the areas of monetary and fiscal policies, exchange rate management, and statistical systems, the IMF and donors collaborated to provide assistance in drafting new laws and regulations consistent with international best practices and the country's situation. Experts provided recommendations on implementation of the new provisions, advice on the reorganization or replacement of central institutions, and resident advisers to give hands-on assistance to build staff capacities. Technical assistance and training related to public enterprise reform typically began with seminars on international experiences, followed by cooperation to devise more targeted strategies for individual sectors and firms.

Albania was a rapid, early reformer. For many countries in transition, crucial economic reforms—such as the adoption of market-oriented prices, establishment of budgetary discipline, and a unified and market-determined exchange rate—have been difficult to implement because of resistance from entrenched interest groups fearful of losing their privileges. But in Albania, many of these measures were begun during the first year of IMF membership. In part this resulted from the previous regime failing so comprehensively. The people were ready for a new direction. Moreover, public support was helped by IMF and World



**The miracle of a fresh coat of paint. Soviet-era buildings got a fresh look in Albania's capital in the early 2000s to show a country being transformed.**

MAGALIE L'ABBÉ/FLICKR

Bank assistance in the design of social transfer programs to mitigate the impact of price increases on vulnerable groups.<sup>5</sup>

The IMF played a catalytic role, enabling the country to obtain sizable grants and loans from other international donors from the beginning of its transition, along with debt relief from commercial banks and bilateral lenders. Without the IMF's tutelage and seal of approval, such access to external resources would have been unattainable for a country only beginning to emerge from the most severe type of Communist system, with a dismal track record in its previous dealings with foreign creditors and donors.

Most importantly, building on Albania's IMF programs, the World Bank quickly became a major concessional lender while the EU, Italy, and other donors increased their grant assistance.

Commercial banks and the Paris Club agreed to debt restructurings and debt reduction. During 1992-96 disbursements of grants and concessional loans totaled \$1.5 billion (about \$500 per capita for Albania's three million people), and \$600 million of external debt was cut by 60 percent, with the remainder restructured over a longer term.<sup>6</sup>

### A "Win" for Albania's People

**R**eengagement with the global financial system and Albania's own policy reforms have produced significant improvements in the standard of living. A tripling of real national income per capita<sup>7</sup> has been accompanied by improvements in health outcomes, educational attainment, and life expectancy. Transportation infrastructure and public utilities have been

modernized.

Nevertheless, popular expectations have sometimes exceeded what was realistically achievable. Economic liberalization yielded immediate, highly visible and broadly shared benefits, but the disruption of the public enterprise sector also led to a surge in unemployment that took years to reverse. Transition in Albania was not seamless. A failure to address financial sector and public enterprise reform in a timely manner

contributed to social and political turmoil in 1997-98 and again in 2009-13.

In addition to the gains for Albania itself, the country's membership in the IMF has been advantageous for other European countries and the United States. It was, of course, important for Italy and other European countries to contain the risk of a continued large-scale flow of refugees. But benefits of Albanian integration into the global community reach beyond

that, including cooperation in fighting cross-border crime, maintaining regional stability in the Balkans, and providing new opportunities for productive investment.

**The IMF played a catalytic role, enabling Albania to obtain sizable grants and loans from other international donors from the beginning of its transition.**

### Is Albania a Lesson for Cuba?

**A** number of major differences exist between the situation of Cuba today and Albania in the early 1990s. Cuba has a larger population (over eleven million, compared with about three million in Albania) and a higher per capita income (around five times Albania's in 1992).<sup>8</sup> Unlike Albania, Cuba is not isolated (either politically or linguistically) from its surrounding region. The island has undergone major structural changes since the Soviet era and is in the midst of a process of liberalizing



**Entrepreneurs are popping up on Cuban sidewalks and street corners since President Raúl Castro began to expand the small-business sector in the late 2000s.**

reforms. It also has an extensive system of data collection and reporting. But transparency is lacking and comprehensive distortions in the price system create major problems in terms of aggregation of values. Finally, Cuba was (unlike Albania) previously a member of the IMF (until its withdrawal in 1964).

But significant similarities offer important lessons. Both countries threw off the yoke of an imperial power in the early twentieth century, and have experienced a long period of disconnection from the international financial system.

Like Albania before the collapse of the Soviet bloc, Cuba has a heavily distorted and inefficient economy, a communist government, and untapped potential for light manufacturing, service industries, and tourism development.

To what extent might Albania's experience presage what might be expected if Cuba were to pursue economic reform and membership in the international financial institutions? The following appear to be key lessons:

- Reengagement is likely to yield benefits for Cuba and for the rest of the world (including the United States), stemming from new opportunities for trade and investment, greater regional stability, and reduced risk of a migrant crisis.
- The gains from IFI membership will depend both on success in catalyzing other external support, and (even more) on the progress of economic reforms that improve its economic performance and investment climate.
- An increase in international economic

integration can accelerate the process of economic and political liberalization.

- The replacement of a centrally-planned economy with one based on free markets typically needs a long period of training, education, and restructuring of public institutions. The IMF and other external sources (including the US government) can play an important role in facilitating the learning process.
- Popular expectations may outrun the benefits of reform and reintegration, especially if citizens have limited familiarity with market mechanisms. New opportunities and improvements in the availability of consumer goods and essential inputs will emerge. But establishing a modern and stable financial sector, restructuring and rationalizing public enterprises, and becoming a strong international competitor will likely take time. Improving the availability and quality of public information can help to dispel uncertainty and encourage public participation in domestic policy debates.

THE VIETNAMESE EXPERIENCE

LUIS RUIZ TITO/FLICKR



**Economic liberalization in Vietnam led to a booming tourist sector and the construction of luxury hotels.**

Vietnam had already been revising the economic model established by the Soviet Union when it rejoined the international financial institutions, but the process, known as Doi Moi, began in the 1980s, before the Soviet collapse. At the time, a US embargo was still in place. In 1993, seven years after initiation of Doi Moi, and while US policy was starting to shift, Vietnam renegotiated a pending debt with the IMF and began to receive new loans from the institution. In 1994, it joined the World Bank; the United States lifted sanctions in the same year.

Since 1994, Vietnam has benefited from loans from the IMF and World Bank, and the economy has flourished. From 1995-2005 the international economic opening widened and growth accelerated, investment increased, industrialization advanced, and household consumption rose. Average annual GDP growth climbed above 7 percent, trade grew from 56 percent to more than 100 percent of GDP, and annual foreign direct investment inflows grew from \$780 million to \$1.6 billion. Industry and consumption nearly doubled their growth rates.

For Vietnam, cooperation with the IFIs helped to ease its balance of payments constraint and foster its access to international capital markets and global integration. Exports and international financing played an important role in economic improvement. There were also benefits from a structural change occurring in 1995, when Vietnam first entered IFIs. These changes, according to econometric estimates, have added 2 percent GDP to the Vietnamese annual GDP growth rate.

That said, there are also important differences between Vietnam and Cuba. In terms of GDP and economic development, Vietnam started from a much lower base, and its location in Asia meant that it was far less affected by US sanctions than Cuba, and was able to enjoy a strong external stimulus from the rapid growth of neighboring economies. The two countries are therefore not directly comparable, although the similarities are sufficient to expect IFI membership to have a positive impact on Cuba's economic growth.

# Why Should the United States Support Cuba's Reintegration?

**T**he international community broadly supports Cuba's integration into the global economy and would welcome a decision to pursue joining the IFIs. For the United States, legal obstacles remain to acceptance of Cuban membership.<sup>9</sup> But Cuba's accession to the IFIs would be consistent with the new US policy, while demonstrating US support for Cuba's wider international engagement.

International ramifications of the US-Cuban rapprochement are already apparent: in June 2015, Cuba announced a breakthrough in negotiations with the Paris Club with an agreement on debt arrears now expected before the end of the year. Discussions with the European Union toward a cooperation agreement have made important progress, and a host of international politicians and business

leaders have visited in 2015, opening the way for new areas of cooperation, trade, and investment.

## What Is the Best Way to Help the Cuban People?

**E**ngagement should be more successful in helping the Cuban people than previous policies of isolation, particularly at a moment when the country is going through a process of far-reaching economic and institutional reforms. The government has acknowledged that to increase public-sector wages, it needs to boost the productivity of state companies and reduce a glut of workers in the public sector. This requires meaningful measures of productivity and profitability that imply decentralization of decision-making, with prices and markets replacing the old system

of centralized planning. To slim down the public sector without creating an unacceptably high unemployment rate, the Cuban government has accepted the need to allow the domestic nonstate sector to grow and attract more foreign investment.

The appetite for reform is strong. After twenty-five years of post-Soviet adjustment and patchy results from limited reforms, there is a consensus that the economic system and old institutions require a fundamental overhaul. A profound sense of frustration, with real wages remaining below 1990 level



**Economic reforms have allowed thousands of Cubans to open small craft and skill-based businesses, but the categories of permitted businesses could be greatly expanded.**



ROBERTO STUCKERT FILHO/FLICKR

**Brazilian President Dilma Rousseff inaugurates the Brazil-funded Port of Mariel in Cuba with President Raúl Castro. Cuba hopes it will become the largest volume port in the Caribbean.**

and the pillars of the socialist model (strong health, education, and social services) deteriorating, has created a moment of opportunity for new ideas.

The overhaul of the public sector and opening to nonstate enterprise has won the enthusiastic backing of most Cubans, but not all. Engagement can help to consolidate support for reform. Resistance to reform comes not only from those who fear a loss of power, status, and privilege, but also from economically vulnerable groups whose livelihoods might be threatened. The degree of resistance will be inversely related to the extent to which the reform process can deliver improvements—in wages, public services, infrastructure, a social safety net for the vulnerable, and economic prospects for the ambitious. The legitimacy of the reform process will be reinforced by improvements in the Cuban economy. As part of this engagement, Cuban membership

in the IFIs, by supporting economic growth, would help to underpin economic reform.

The IFIs' experience of reform has involved not only liberalization but also the construction of the necessary institutional architecture—including financing instruments and mechanisms, procedures

**Cuban membership in the IFIs would support economic growth and help to underpin reform.**

for project management, monitoring and evaluation, regulatory systems, contract laws, taxation regimes, payment mechanisms, insurance, accountability and labor, and consumer and environmental protection. Solid institutions replace centralized control with a system based on free markets, competition, and transparency. The benefits

go not only to large foreign investors but also to small businesses, farmers, employees, and consumers. The wider the benefits of reform are spread, the more popular they will be; once in place, reversal will be increasingly difficult.

# Recommendations for Cuba, the United States, and the International Financial Institutions

**C**uba is at a moment of profound economic transformation and the openings in US policy—with more movement expected from Congress—have recast both the bilateral relationship as well as Cuba's broader international engagement. Economic reform and full reintegration into the global economic community will provide further momentum for a nascent Cuban private sector while improving the lives of everyday Cubans.

Isolation is increasingly a policy of the past; Cuba, the United States, and the international financial institutions must catch up to this reality. To do so, each must rethink outdated policies. The end goal is to understand that joining the IFIs is a critical step in the long-term process of full economic reintegration.

Here are ten actions that each should take:



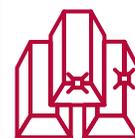
## Cuba

- Cuba should examine the potential paths toward IFI membership. Precedents provide an indication of the potential benefits, as well as a guide to priorities and procedures.



- Progress in external debt negotiations can help to pave the way for membership. The agreement reached with the Paris Club is an important step. Reform progress, a leadership succession, and the improvement in US relations should help catalyze further progress.

**Full reintegration into the global economic community will provide momentum for the private sector while improving the lives of everyday Cubans.**



- Currency reform should be a priority. It has important ramifications both for restructuring and the international integration of the economy. The IFIs are particularly well-equipped to assist with monetary unification. The government should take advantage of the technical support and expertise the IFIs can offer.



- The quality, international comparability, and transparency of Cuban monetary and financial data will need to be improved, not only for access to the IFIs, but also to attract more foreign direct investment.



DAVID SASAKI/FLICKR

### United States



- The United States should give maximum leeway to the IFIs to begin confidence-building discussions and offer technical assistance to Cuba.



- Cuban membership in the IFIs should be included in bilateral discussions with Cuba. The various approaches suggested in this paper provide indications of the way forward.



- President Obama should make a public statement to assert his authority in interpreting legislation designed to obstruct Cuba's membership in the IFIs through the threat of withdrawal of funds. This public statement will provide the IFIs—today hesitant about incurring US congressional disapproval—with political cover to engage Cuba.



- Where possible, President Obama should work with leaders of the relevant congressional committees to reach compromises to allow progress

toward Cuban membership of, and access to financing from, the IFIs. This might, for example, involve an agreement for a limited-term “truce” (through the coming presidential election) whereby Congress agrees that it will not withdraw funds from IFIs if assistance is given to Cuba.



### International Financial Institutions

- The IFIs should begin to offer technical missions to Cuba as was done in Albania and other countries re-entering the international financial system. These can begin to build a culture of trust, and Cuba can gain an understanding of the benefits of IFI membership.



- The IMF, World Bank, and the IDB should create a steering group to begin officially engaging the Cuban government. This steering group might be chaired by Luis Alberto Moreno, President of the IDB, an institution well poised to facilitate Cuba's broader reintegration.

## Endnotes

- 1 Cuban National Office of Statistics and Information, 2014, <http://www.one.cu/sitioone2006.asp>.
- 2 The increase in intentions to invest in Cuba was corroborated in the Cuba Standard Business Confidence Survey, applied in the first quarter of 2015. See [https://www.cubastandard.com/?page\\_id=12796](https://www.cubastandard.com/?page_id=12796).
- 3 The need for sufficient fiscal resources to absorb the effects of the eventual devaluation of the official exchange rate has been highlighted in various studies. For example, see chapters from Augusto De la Torre and Alain Ize, "Exchange Rate Unification: The Cuban Case," and Pavel Vidal and Omar Perez, "Monetary Reform in Cuba Leading to 2016: Between Graduation and the Big Bang," both in Richard Feinberg and Ted Piccone (eds), *Cuba's Economic Change in Comparative Perspective*, Washington, DC, Latin America Initiative Brookings Institution, 2014.
- 4 Richard Feinberg, *Reaching out: Cuba's new economy and the international response*, Brookings Institution, 2011, and Joaquin Pujol, "Membership Requirements in the IMF: Possible Implications for Cuba", Association for the Study of the Cuban Economy, 2014, <http://www.ascecuba.org/c/wp-content/uploads/2014/09/v22-pujol2.pdf>
- 5 Scott Brown, Caryl McNeilly, Paul Mathieu, Caroline van Rijckeghem, and Reva Krieger, *IMF Economic Review of Albania*, International Monetary Fund, No. 5, July 1994.
- 6 World Bank, *Albania Country Assistance Evaluation*, November 2000.
- 7 World Bank, *World Development Indicators*, July 2015 <http://data.worldbank.org/data-catalog/world-development-indicators>.
- 8 Estimates of Cuban US dollar equivalent GDP per head are hazardous, given its huge price and exchange rate distortions. Official Cuban data suggest a figure of around US\$5,900. The World Bank estimate suggests a 2014 level close to US\$8,000 (<http://databank.worldbank.org/data/views/reports/tableview.aspx?isshared=true>) and the Penn World Tables (Alan Heston, Robert Summers, and Bettina Aten, *Penn World Table Version 7.1*, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania, November 2012; [https://pwt.sas.upenn.edu/php\\_site/pwt\\_index.php](https://pwt.sas.upenn.edu/php_site/pwt_index.php)) imply income per head at PPP in 2014 (in 2005 prices) of over US\$11,000. In constant per capita 2005 US dollar terms, the World Bank estimate suggest that Cuba's GDP in 2014 was around US\$5,300, compared with US\$1,100 in Albania in 1992, <http://data.worldbank.org/data-catalog/world-development-indicators>.
- 9 The implications of the new US policy toward Cuba have been analyzed by various researchers. For example, the following works may be consulted: Carmelo Mesa-Lago, "Normalization of relations between the US and Cuba: causes priorities, obstacles, effects and dangers," Working Paper 6/20, Real Instituto Elcano, 2015; Ernesto Hernandez-Cata, "Preparing for a Full Restoration of Economic Relations between Cuba and the United States", Association for the Study of the Cuban Economy, 2014; and the dossier from Cuba Possible titled "Cuba and the US: Dilemmas of the Change," February 2015, [http://cubapossible.net/publicaciones?&per\\_page=5](http://cubapossible.net/publicaciones?&per_page=5).

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*The authors would like to thank Ernesto Hernandez-Cata, Lorenzo Pérez, and Phil Peters for their thoughtful comments on early drafts.*

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