

March 23, 1995

## A BLUEPRINT FOR A FREE CUBA

### INTRODUCTION

Congress is considering legislation to help end President Fidel Castro's stranglehold on the Cuban people. The Cuban Liberty and Democratic Solidarity Act, sponsored by Senator Jesse Helms (R-N.C.) and Representative Dan Burton (R-IN) would tighten the U.S. economic embargo on Cuba, penalize buyers of illegally confiscated American property in Cuba, and withhold economic assistance until Cuba establishes a transitional government.

This legislation is intended to finish something begun decades ago: the liberation of Cuba, once and for all, from Castro and communism. Castro has ruined Cuba's economy, oppressed its people, and been a persistent security problem for the United States. In a very real sense, he is the problem in Cuba. Ridding Cuba of Castro and his cronies is a first step toward freedom and prosperity. It is good not only for U.S. and hemispheric security, but for the Cuban people as well.

Life in Cuba is so miserable and repressive that an estimated 40,000 Cubans tried to flee in August 1994 alone. U.S. Coast Guard and Navy ships rescued 32,000 of these refugees, but thousands of others perished at sea. Why is this happening? Because Castro's communist system is collapsing. With the end of communism in Eastern Europe, Castro lost both his ideological base and billions of dollars in Soviet subsidies. Unable to provide the public services and well-being at the core of the social pact between the people and the communist state, Castro has lost legitimacy and credibility in the eyes of millions of Cubans.

One can only speculate as to how long this collapse will take, but it is certain to be followed by a period of confusion that, properly exploited, can lead to a free-market democracy. For this to happen, a post-Castro Cuban government would have to:

- ✓ **Dedicate** itself to the principle of democratic pluralism.
- ✓ **Support** a general amnesty for all members of the former communist regime.
- ✓ **Draft** a new constitution and abolish all legislation which bars free enterprise and democratic political freedoms.
- ✓ **Cut** the Cuban Army by at least 50 percent and dismantle Castro's police state.
- ✓ **Ask** the Organization of American States to help build democratic institutions.
- ✓ **Quickly privatize** state-owned enterprises and eliminate all state monopolies.

When Castro's regime does fall, the U.S. government should have an action plan to help rebuild Cuba's economy and civil society. To return to normalcy, a post-Castro government will need to enact sweeping economic and political reforms. It also will need help from the U.S. and other countries. If this new government is democratic and reformist, the U.S. should move quickly to welcome a free Cuba into the fold of democratic nations. Under these circumstances, the U.S. should:

- ✓ **Abolish the trade embargo.** This would be contingent upon Castro's fall from power and the establishment of a mechanism for building a democratic political structure and free-market economy.
- ✓ **Restore Cuba's most favored nation trade status.** This would provide markets for Cuban exports at lower tariff rates.
- ✓ **Negotiate a free trade area agreement with Cuba as soon as possible.** This would give Cuba long-term access to the U.S. market while ensuring U.S. investors and exporters access to the Cuban market.
- ✓ **Restore Cuba's share of U.S. sugar imports to its 1958 level.** This would allow Cuba's largest export immediate access to the U.S. market.
- ✓ **Provide humanitarian aid to relieve immediate suffering, but avoid the economic aid trap.** Only aid aimed at stopping immediate human suffering like food, shelter, clothing, and medicine should be given. Economic aid will harm Cuba's long-term prospects for economic reform.

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What should the Cubans do after Castro? Although the Cuban dictator shows no signs of stepping down, the severity of the Cuban crisis suggests the need to begin planning for when he does. The most immediate task would be for the Cubans themselves to devise some form of successor government. Assuming that Castro's successors wanted to improve conditions and reach out to the outside world, this government would have to embark on a reform program. To build democracy and a market economy, a post-Castro government would have to:

- ✓ **Dedicate itself to the principle of democratic pluralism.** A transition period of between six and twelve months may be necessary to establish the basis for a democratic government in Cuba. Since the Cuban armed forces and communist party are

so strong, they may be represented in a post-Castro government. Reformist elements within the Army and communist party could form a provisional governing committee with representatives of Cuban exile communities, leaders of the island's organized dissident groups, and possibly officials of the Cuban Catholic Church. Achieving an ideologically balanced committee would be a challenge, but the process can be facilitated if members are committed to free-market reforms and creating a politically pluralist democracy. This transition government committee should be set up to exist for no more than twelve months.

- ✓ **Support a general amnesty for all members of the former communist regime.** Efforts to seek revenge for past human rights abuses and crimes could create much unnecessary social and political conflict, slowing the reconstruction process. One of the first tasks of any government responsible for guiding Cuba's difficult transition to democracy should be amnesty for all members of the former communist regime who commit themselves to working peacefully and democratically for the island's economic and political reconstruction. Cuba's first democratically elected Congress should incorporate the transition government's amnesty into binding legislation.
- ✓ **Draft a new constitution and abolish all legislation which bars free enterprise and democratic political freedoms.** The transitional government should issue a decree permitting dissident groups to form political parties. It also should set a date for an internationally supervised referendum to elect a Constitutional Assembly to draft a new constitution.

The referendum should empower the Assembly to abolish all laws which prohibit or restrict private enterprise and private ownership of property, and the Assembly should set a date for internationally supervised democratic elections. Ideally, drafting a new constitution and holding democratic elections should take from six to twelve months. The first tasks of the democratically elected Congress would be to ratify the new constitution and review all decrees or resolutions issued by the transition government.

- ✓ **Cut the Cuban Army by at least 50 percent and dismantle Castro's police state.** In a democratic Cuba, there will be no need for the huge military and state security apparatus that today forms the core of Castro's repressive communist government. Resources now allocated to maintaining Castro's police state can be freed to help dismantle it.
- ✓ **Ask the Organization of American States to help build democratic institutions.** Some Cubans may still distrust the United States and its efforts to build democracy in Cuba. Therefore, it would be wise for the OAS to step in during the transition period. The OAS is composed of other Latin American countries that have worked to establish democratic, free-market societies and could provide valuable advice to a post-Castro government.
- ✓ **Quickly privatize state-owned enterprises and eliminate all state monopolies.** Cuba must move quickly to transfer ownership of productive assets from the state to individuals. This is crucial because the sooner individual owners can benefit directly from privatization, the more quickly the production of goods for consumption or trade will grow. Privatization in other ex-communist countries often has been delayed as policymakers have sought to determine the value of state-owned assets be-

fore selling them to private investors. But viewing privatization as a source of revenue for the state merely slows the process as government bureaucrats hold out for higher bids. Moreover, it is an unethical practice because the assets being sold are property the state has stolen from private individuals.

A new Cuban government will have at its disposal a wide range of options in transferring government property to private hands quickly and efficiently. Smaller businesses could be sold directly to their employees. Larger enterprises might be reorganized and sold to workers under employee stock ownership plans. The experiences of the Czech Republic, the Baltic States, and even Russia offer a variety of examples of what to do and what to avoid. Cuba need not reinvent what has been discovered elsewhere.

**The Role of Foreign Investment.** Foreign investors could be allowed to purchase shares in Cuban firms after the U.S. embargo has been lifted. However, any business that existed before the Cuban revolution and still survives after Castro's departure should first be offered to its original owners. For example, Chrysler Corporation, Johnson and Johnson, Inc., Texaco Corporation, and a host of other companies had their property confiscated by Castro. These factories and businesses were pillaged by the communist bureaucrats who seized control of them.<sup>1</sup>

Investors from Canada, Mexico, Germany, and other countries have bought these confiscated properties from the Castro government. However, by doing this, they essentially have bought stolen property which the Cuban government had no right to sell. These properties should be returned to their rightful owners by the post-Castro government.

**Reviewing Property Claims.** In order to privatize state-owned assets and to make certain that previous owners recover their property or receive compensation, the new Cuban government should establish a privatization oversight agency and a property claims court. The oversight agency would coordinate and implement the privatization program. It also would process claims for confiscated assets. The independent property claims court would review cases in which there are several claimants or other complications. In such cases, the privatization agency would act in accordance with the claims court decision. If cases cannot be decided within a certain length of time, the agency would proceed with its plans to dispose of the assets, and privatization would not be delayed. When the court finally reached a decision, the winners would receive compensation.

The privatization agency might avoid court delays and conflicts by giving vouchers to legitimate claimants reflecting the value of their claims. They could be used to bid on the assets that are for sale. Thus, former owners would be compensated for their loss of property.

The agency should establish a time limit within which all claims must be made. In addition, a certain percentage of the proceeds generated from asset sales could be set

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<sup>1</sup> Telephone interview with Thomas E. Cox, Executive Director, U.S.-Cuba Business Council, Washington, D.C., March 1995.

aside to compensate people with legitimate claims who were unable to win back their property through the bidding process. While compensating former owners of private property is important, the overriding goal of privatization should be to return government-owned enterprises to the private sector as quickly as possible.

- ✓ **Eliminate abusive government regulations and establish a quick process for obtaining a business license.** In many less-developed countries, obtaining a business license is very complicated and time-consuming, sometimes requiring bribes and kickbacks. Even after businesses are granted a license, the huge costs of complying with the haphazard application of numerous regulations may nearly bankrupt them.

A post-Castro government will be tempted to impose many regulations to “manage” the transition to a free-market economy. This would be a mistake. Instead of imposing oppressive regulations, the new Cuban government should consider “self-regulation regimes” like those that exist in the United Kingdom: voluntary associations of businesses that produce similar products and establish their own product safety, health, and other standards. Each association has a label or trademark that appears on the product produced. It is up to the consumer to decide for himself or herself which standards justify the cost of the product. Companies that do not participate in the self-regulating regime are unable to use the trademark and thus unable to claim that their product meets the industry-set standards.

In addition, the new government should establish a “one-stop shop” for business licenses and even offer them through the mail. Such a system will allow potential business owners to set up shop quickly without the delays that exist today in many other developing countries.

- ✓ **Establish a stable, convertible currency.** To facilitate economic activity, international trade, and privatization, the new government of Cuba should move quickly to establish a stable, convertible currency. A growing, advanced economy cannot exist without a sound currency as a store of value—something people can save to use for purchases or investments. A sound currency also serves as a medium of exchange, allowing businesses and individuals to trade with one another, while saving the expenses and eliminating the inefficiencies of a barter economy. To perform these functions, a currency must keep its value over time. Thus, it must not become inflated.

Some reformers may suggest that Cuba’s central bank should be given the task of making Cuba’s peso a stable currency. This also would be a mistake. It was this bank that ran the printing press to fund the Cuban budget deficit and provide massive subsidies to the public sector, inflating the Cuban currency and making it worthless.

**Currency Board.** Rather than work through the central bank, the new Cuban government should abolish it and establish a system in which the currency cannot be manipulated easily by the government. The government could use the U.S. dollar for its currency, but this might create political problems, with national pride leading the Cuban people to reject the U.S. dollar.

Johns Hopkins University economist Steve Hanke and George Mason University economist Kurt Schuler suggest that ex-communist countries set up independent currency boards to establish a convertible domestic currency.<sup>2</sup> The same could be done

for a post-Castro Cuba. A currency board issues notes and coins that are backed directly by a foreign currency, such as the U.S. dollar. Citizens and businesses could exchange these notes and coins for dollars or for any other established currency, basket of currencies, or commodities at a fixed rate. Market forces, not a central bank, would determine the money supply. Over 60 countries have instituted currency boards since 1900. Hong Kong and Singapore are notable examples of economies with very stable currencies overseen by currency boards.<sup>3</sup> Hong Kong, for example, has had an average inflation rate of about 7 percent since 1980. Singapore's average inflation rate between 1980 and 1991 was only 1.9 percent.

- ✓ **Establish a legal and institutional framework to protect private property.** The core of the free-market system, from which all other principles derive, is the right to own and dispose of private property as one sees fit. Proclaiming this right is relatively easy. Guaranteeing it, especially against government expropriation and abuse, is far more difficult. Privatization and a stable currency will bring prosperity only if the right to own property is fully protected.

To achieve this goal, a new Cuban government should re-establish the commercial code of business that existed before Castro. A commercial code sets the rules for all free-market activities and transactions. It defines what a contract is, what constitutes a buyer and a seller, and how disputes should be arbitrated. But enforcing contracts and arbitrating disputes also requires an institutional framework. This means establishing a judicial system with its own binding, independent powers to protect the integrity of private property and the right to contract, which in turn may well mean abolishing all existing communist courts and appointing a completely new judiciary.

- ✓ **Liberalize trade and eliminate restrictions on foreign investment.** Free trade is necessary for countries attempting to overcome decades of economic decay under communism. High tariff and non-tariff barriers add to the costs of machinery, equipment, and other goods needed to increase productive economic activity. Trade barriers also price consumer goods out of reach of many workers and lower the living standards of others, removing incentives to work hard and to be productive.

Trade was very important to Cuba's economy before Castro, accounting for 57 percent of gross national product. Before the revolution, the U.S. was Cuba's principal trading partner. Reestablishing trade ties with the U.S. and the rest of the world is crucial to Cuba's economic recovery.

The trade practices of a free-market Cuba should conform to those outlined in the General Agreement on Tariffs and Trade (GATT). Though Cuba signed GATT in 1947 and remains a participating member to this day, it has drifted from the Agreement's free-market principles. Cuba should start by complying with the Harmonized Tariff Classification and Coding System to bring its trade accounting methods in line with the rest of the world. It also should amend and clarify its customs laws to harmonize them with international trade standards.

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2 Steven H. Hanke and Kurt Schuler, "Currency Boards for Eastern Europe," *Heritage Lecture* No. 355, December 12, 1991.

3 *Ibid.*

While some claim that it has made some progress in opening its economy to foreign investments and imports, Castro's Cuba remains anything but a free and open market. Customs officials are notorious for their corruption, often requiring bribes, kickbacks, and other special favors to release imported goods held at the border. In other cases, the scarcity of goods has provided incentives for corrupt border officials to steal imported goods and keep them for their own use. Cuba's customs system will need to be entirely overhauled to root out these border bandits.

By removing restrictions on legal foreign investment, a free Cuba could receive as much as \$3 billion in foreign investments from Cubans now living in exile—an infusion of capital not available to most ex-communist countries. A post-Castro government should make it easy for foreigners to invest. An especially promising source of capital might be joint ventures and strategic alliances that allow foreign companies to manufacture products jointly with private Cuban companies. Because both partners gain by sharing costs and information, newly privatized Cuban companies could greatly expand their access to new technologies, management techniques, distribution channels, and capital. To make joint ventures attractive, Cuba should avoid strict antitrust laws that discourage such alliances.

- ✓ **Promote rapid development of competitive and efficient financial institutions, including stock and bond markets.** A new Cuban government should move quickly to establish a free banking system. In doing so, it should take a lesson from the United States on what not to do. The U.S. separates investment banking from savings and loan banking. But making banks less diversified often makes them less able to deal with economic hard times that might reduce profits for one banking activity, like savings and loans, but not for another, like investment banking. A post-Castro government should allow its banks to engage in all forms of banking activity. It should not separate investment banking from savings and loan banking.

**Fostering Small Banks.** A new Cuban government also should create cooperative banks. These are small banks, operated locally by individuals that lend mainly to other individuals. These banks provide small lenders immediate access to credit that might be denied by larger banks, which have a tendency to lend to businesses and corporations rather than to individuals.

Cuba should avoid America's banking insurance mistakes. The U.S. government insures banking deposits and charges the same rate regardless of whether a bank's lending policies are reckless or sound. This is like charging the driver who has had many accidents the same price for auto insurance as those who have never had an accident. Banning market pricing of insurance in banking has removed the market incentive of high insurance rates that would discourage irresponsible or risky lending. This was a major cause of America's savings and loan crisis during the early 1990s.

To avoid this problem, a new Cuban government at a minimum should charge banks market rates insurance. Better still, in the long term, Cuba should allow private insurance companies to underwrite its banks.

**Competing Currencies.** After Cuba has established a currency board to stabilize its monetary policy, it should consider developing a banking system in which all currencies are legal tender, including those issued by private institutions. Such a financial system would be analogous to a banking system in which individual banks issue

a variety of instruments such as checks or credit cards, depending on consumer preference. Similarly, the Cuban government should permit Cubans to determine what currency best suits their needs, whether for trade transactions, investment, or individual consumption. Such a system would foster maximum competition among banks and minimize the possibility of government manipulation of the currency. Moreover, it would set an example of a free-market monetary and banking system that could become the model for other countries, including the U.S.

A sound stock and bond market is necessary to attract domestic and foreign investments. It also can assist government privatization efforts: a functioning Cuban stock market would be an ideal place to sell off large state-owned enterprises. The stock and bond market is a fundamental function of a free market. It allows buyers and sellers to establish the conditions for purchasing and disposing of property. A private stock and bond market will be essential in a post-Castro Cuba.

- ✓ **Establish a tax structure that promotes economic growth.** The new Cuban government would do well to design a tax structure that balances the need to generate revenue with the disincentives inherent in any tax scheme. Taxes, by their nature, discourage individuals from engaging in the activities that are being taxed. Thus, Cuba should avoid income and business taxes altogether. These taxes penalize the very activities that should be least burdened—working and starting businesses—by removing assets from the hands of the most productive forces in the economy.

A post-Castro Cuba would be better off with a system that taxes consumption, like a national sales tax, which affects all individuals equally because they pay only on what they consume. Taxing consumption penalizes individual productivity less than taxing income or business does. Less desirable—but still better than an income or business tax with progressive rates—is a flat tax imposed equally on all income levels. For example, a 15 percent flat tax applies to the person who makes \$5,000 a year as well as to the person who makes \$50,000 a year. Thus, people are not punished for being productive.

Finally, the new Cuba would do well to pass a constitutional requirement that limits the size of its budget to a percentage share of gross domestic product. By holding down spending, the government would help assure that taxes remain low while the economy continues to expand.

## AMERICA'S ROLE IN A FREE CUBA

The United States should help a reformist Cuba make its way toward democracy and a free-market economy. To prepare for the day when Castro is no longer in power, the U.S. should have a plan ready to deal with the post-Castro era. A freely elected government, in the view of many economists, will make Cuba once again one of America's most important trading partners in the hemisphere. It therefore is in America's interest to help Cuba change from communist totalitarianism to democracy and a market economy. To do this, the U.S. should:

- ✓ **Abolish the trade embargo.** When Castro is gone, and immediately following free elections in Cuba (but not before), the U.S. should eliminate the trade embargo. American businesses should be given the chance to trade and invest in Cuba as



quickly as possible. Abolishing the embargo will encourage further economic reform and the elimination of restrictions that hinder investment by and trade with the U.S.

- ✓ **Restore Cuba's most favored nation trade status.** Cuba was one of the original signatories of the General Agreement on Tariffs and Trade in 1947. Since Castro's takeover in 1959, however, Cuba has not conformed to GATT rules and procedures. In 1962, because of Castro's anti-Americanism, the U.S. revoked Cuba's most favored nation status, which normally provides each GATT member with equal trade treatment.<sup>4</sup> Also in 1962, the U.S. imposed a trade embargo which, for the most part, remains in effect. Renewing Cuba's most favored nation status would ensure that Cuban exports to the U.S. are treated as fairly as those from the rest of the 112 GATT member countries with which the U.S. trades. It also would help Cuba, in the short run, to attract investment capital.
- ✓ **Negotiate a free trade area agreement with Cuba.** As Cuba overcomes the difficulties of reorganizing its ruined economy, the U.S. should be prepared to start negotiating a free trade agreement with Cuba that removes all tariff and non-tariff barriers to trade between the two countries. In the long term, the U.S. should help negotiate Cuba's entry into the North American Free Trade Area with Mexico and Canada.

**Framework Agreements.** U.S. trade negotiators first should work with a free Cuba to establish the framework agreements necessary to bring Cuba into the North American Free Trade Area. These agreements, which already exist for most Western Hemisphere countries, establish the basis for free trade negotiations, often setting target dates for negotiations, topics of discussion, and the objectives of such discussions. The U.S. then should negotiate a bilateral free trade agreement with Cuba as quickly as possible. This would avoid the delays that would result if the U.S. tried to bring Canada and Mexico into the negotiating process from the start.

- ✓ **Restore Cuba's share of U.S. sugar imports to its 1958 level.** Sugar is Cuba's largest export commodity. The U.S. government established a quota system in 1934 that restricts sugar imports. The U.S. sugar quota for Cuba in 1958, for example, was 3.2 million metric tons a year. Since then, the embargo has barred all Cuban sugar exports to the United States. As a result, the American sugar industry remains highly protected from Cuban competition.

After Castro falls, it will be necessary to stimulate Cuba's economy by increasing Cuban sugar exports. To give Cuba an immediate market for its main crop, the U.S. will need to restore a substantial portion of the 1958 3.2 million ton annual sugar quota. In the long term, Cuba must diversify its economy and increase foreign exchange earnings in tourism, manufacturing, and numerous agricultural goods, but increasing sugar exports would allow it quickly to earn much-needed hard currency.

Higher sugar imports will mean lower prices for American consumers and for American enterprises that use sugar in their products. Studies have shown that sugar quotas cost Americans from \$600 million to \$3 billion a year in higher prices.<sup>5</sup> To

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4 See Tariff Classification Act of 1962, Public Law No. 87-456 stat. 62 (1962).

5 See U.S. Department of Commerce, "United States Sugar Policy, An Analysis" (Washington, D.C.: U.S. Government

combat high costs to consumers, America should open its sugar market. The emergence of a post-Castro Cuba would give policymakers an ideal opportunity to begin to scrap the U.S. sugar quota system.

- ✓ **Provide humanitarian aid to relieve suffering, but avoid the economic aid trap.** Cuba might well be the one country that emerges from communism without even a pretense of needing foreign aid. The two million Cubans now living in exile in the U.S. are expected to provide as much as \$3 billion a year in investments and assistance to a free Cuba. This infusion of private capital surely would dwarf any economic assistance from the U.S. government. Moreover, the failure of the U.S. Agency for International Development (AID) over three decades to bring prosperity to less-developed countries suggests that little can be expected from bilateral foreign aid to Cuba. Experience in Eastern Europe following the collapse of the Soviet empire demonstrates that massive amounts of foreign aid are of little use in developing free markets. Free and open enterprise and investment policies, on the other hand, spontaneously have created economic growth in such former communist countries as the Czech Republic.

The new Cuban government might be tempted to take whatever foreign aid is offered, ostensibly to pay for the transition to a market economy. The U.S. should hold out no such temptation. After a post-Castro Cuba has established guidelines for democratic elections, the U.S. should offer assistance, but only for emergency food or medical help. By using aid in this way, the U.S. can assure that its efforts truly help Cuba instead of causing it to become addicted to foreign aid.

Finally, the U.S. should use its influence with such organizations as the Inter-American Development Bank (IDB), World Bank, and International Monetary Fund to discourage all types of loans and grants to Cuba. These institutions have a long history of funding the very government-controlled economic policies that have maintained poverty and economic stagnation in most developing countries.

## CONCLUSION

The question is not whether Castro's bankrupt communist regime will collapse from its own weight, burying for good the failed utopian vision of Marxism in the Western Hemisphere, but when. Once it happens, a transition government will have to take a number of immediate steps to help arrest political, economic, and social turmoil. These should include a commitment to democratic pluralism; a general amnesty for members of the former communist regime; a new constitution dedicated to limited self-government, private property, and free enterprise; the dismantling of Castro's police state; and a willingness to work with international organizations to effect the transition to democratic capitalism.

Beyond that, there is much the United States can do to assist a free Cuba in its transition to independence and prosperity. The U.S. will have the chance to adopt a "trade, not

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Printing Office, 1988), and International Trade Commission, "The Economic Effects of Significant U.S. Import Restraints," Publication No. 2699, November 1993.

aid" strategy so often avoided with other developing countries. Instead of making Cuba dependent on large levels of U.S. foreign assistance, the most important thing Washington could do would be to establish a free trade relationship once the post-Castro government commits itself to democracy and a market economy.

The often difficult relationship between Cuba and the United States is about to take yet another turn. It will be up to both countries to see that this relationship avoids the pitfalls of the past.

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