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WHAT ROLES FOR FOREIGN DIRECT INVESTMENT
IN THE NEW CUBAN ECONOMY?

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Introduction:

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P R O C E E D I N G S

MR. PICCONE: Good morning, everyone. I hope you have had a chance to get some coffee and something to eat. If those in the back could make their way in, I'd appreciate it. Thank you.

I'm Ted Piccone. I'm senior fellow and deputy director for Foreign Policy here at the Brookings Institution. Welcome, and thanks for coming out on a foggy Monday morning. It's not the ideal time. And because of the fog, we've actually lost one of our panelists who couldn't get off the tarmac in New York, Chris Sabatini from the Council of the Americas. So we apologize for that. Out of our control. But we will try to fill in accordingly.

We're here today to talk about Cuba and recent developments on the island regarding its economic reform agenda, and we're very pleased to have Dr. Richard Feinberg with us to present his latest research on the new Cuban economy, and in particular, looking at the role of foreign investment. This is the second in what I think will turn into a series of original research work that Richard has done for our Latin America Initiative here at Brookings. A year ago, Richard released -- we here at Brookings released Richard's monograph on what role for the international community, financial institutions, and how the development community and the development assistance in all kinds of forms could provide some encouragement and momentum to the Cuban economic reform process. Richard, you'll come back? I'm going to buy some time here.

This study is looking very concretely at the foreign direct investment regime in Cuba, looking at a number of case studies, the experience of several companies, mostly from Europe and Brazil who have engaged in the Cuban economy for many years, and what their experience has been, negative and positive, looking at what additional steps the Cuban regime might consider taking as it looks to continue and

implement its economic reform program. So we'll hear more about that from Richard.

Chris did want to share with me -- Chris Sabatini -- his initial reaction to the study, which he thought was the only product out there that really looks at this issue in an objective way, kind of staying above the fray of the usual kind of politicized analysis of what goes on in Cuba, gets into detailed case studies that highlight the reasons why investors have invested and their difficulties in doing so and staying the course. So I think you'll be pleased with the results. I hope you got a copy when you got in, and we'll get into more details as we get moving this morning.

I think you all know Richard. Richard is a professor of international political economy at the University of California San Diego. Richard has had many years of experience here in Washington as special assistant and director for Inter-American Affairs at the National Security Council in the first term of the Clinton administration. Also, stints at the State Department and at the Treasury Department. He has worked at various think tanks in Washington, including as a fellow -- pre-doc fellow, right? Or is it post-doc?

MR. FEINBERG: Pre-doc.

MR. PICCONE: A pre-doc fellow here at Brookings. Richard has also served in the Peace Corps in Chile, and we're very pleased that he's been associated with us as a non-resident senior fellow.

I will then turn to our other panelist today, Diego Ruiz. Diego is vice president for Global Public Policy and Government Affairs for PepsiCo. I think you all know PepsiCo and its many brands. Diego has just returned from a trip to Cuba with a small delegation of other business leaders organized by the Council of the Americas. So we're going to hear a little bit of firsthand response reaction to that trip, which I think will be interesting.

Diego was executive director of the Securities and Exchange Commission from 2006 to 2011. He also has served at the Federal Communications Commission in a senior position; for 10 years was an executive with Univision; and also served as senior staff in the U.S. House of Representatives. So he's had an incredibly diverse and interesting career, and we look forward to hearing his comments.

We'll then engage in some Q&A and commentary before we wrap it up. So I'll now turn to Richard.

MR. FEINBERG: Thanks very much, Ted. I want to thank Brookings, as always, for, among other things, their remarkable efficiency in organizing a production and publishing process, turning a report around in an incredibly small amount of time and getting it out there, and always looking so aesthetically pleasing. So thank you very much, Ted, and your staff.

I see a lot of friends here. I have to recognize a few. The man who taught me everything I know about foreign investment and capital theory, Professor Donald Harris, who taught for many years at Stanford. Don, thanks so much for being with us. Ambassador Wayne Smith, of course, we always will have in our minds that heroic moment of his in Cuba. Sarah Stephens, who keeps us all informed, thanks very much for being with us. And John Maisto, who taught me a lot of what I know about diplomacy. Thank you, John. Do you want to accept that accolade? (Laughter)

Okay. So when I decided to tackle the issue of foreign investment in Cuba and I mentioned the topic to a number of people, they said, "Feinberg, you can't do it. No one has done it. No one has written about foreign investment in Cuba at any depth. It can't be done. You can't get the information. You can't get access to people. There's no numbers out there." I said, "You don't know Richard Feinberg. I am a dogged persistent character." And so I decided to forge ahead anyway, against better advice.

I was able to take five trips to Cuba all together during a two year period. I started really networking with people I knew in the diplomatic community, and through that I gradually gained access to some of the joint ventures. And in general, the foreign investment community, the expat community. Small but still there is an expat foreign investment community in Havana. So based upon that and then looking for numbers here and there, I was able to put together this report, which I hope you find informative. I have to say that I hope this stimulates other people now to pick up the baton, both in Cuba, as well as international economists, and continue to work on the issue of foreign investment in Cuba. I think it'll only become a more and more important topic.

So first major finding, that in fact, in Cuba today there are a number of multinational firms that are making good money in socialist Cuba today. That's certainly what they tell you right up front. These, of course, are not U.S.-based companies, but European companies, Canadian companies, some Latin American, Brazilian companies, for example. Some brand name companies -- and this is all laid out in the report -- such as Nestle; Unilever; British American Tobacco; the Sol Meliá hotel chain from Spain; Sherrod International, a large mining company based in Alberta, Canada. They all tell you that they are doing well, thank you very much, in the context of socialist Cuba.

At the same time when you look at the numbers, it's very clear that Cuba, the Cuban economy, is benefitting in a very measurable, fundamental way from these foreign investments. The foreign firms market Cuban nickel; they market Cuban rum; they market Cuban cigars; and the international hotel operators bring in tourists who can then stay at either foreign-owned or foreign-managed hotels on the island. It's not just a matter of the money that comes in or the marketing that comes in, because as occurs around the world with the issues of foreign investment, foreign investment arrives in Cuba bundled together with management expertise, with new technologies, with

international product standards, and with sustained product innovation.

Also very important for the Cuban economy, Cuba's credit rating, of course, is not good, but the multinationals can draw on their own global credit ratings to access international lines of credit at standard interest rates, well below what Cuban borrowers would have to pay if they were out there on their own.

So there is a foreign investment presence. But Cuban reluctance and U.S. sanctions together conspire to keep business engagement -- international business engagement well below what would be optimal levels for all parties concerned. The report argues that the Cuban government has driven a wedge, really, a wedge between Cuba on the one hand and this vast ocean of savings of foreign investment that circulates the global; that drives capital formation, technological diffusion, economic growth, and poverty reduction in both developed and developing countries alike.

Now, it's true, as you read in the papers every day, that Cuba has been liberalizing the scope for small business, many as a means of sopping up some of the growing unemployment. And these brave micro entrepreneurs, they make for colorful stories. They are important, but taken together they don't have the weight; they don't have the resources; they don't have the technology; they don't have the access to markets to buy themselves, really turn around the Cuban economy. And as any of you know who have visited the island, the Cuban economy does need turning around. The decaying architecture, the depressing lack of consumer basics; these are all very painful to witness.

So investment flows, although there have been some into Cuba, they're well below international benchmarks. And what I mean by that is Cuba has received -- and this has to be an estimate -- \$3.5 billion of foreign direct investment over the last 20 years. That's tiny; 3.5 billion compared to the 25 billion that it would have received had

Cuba behaved more like a typical developing country. That is to say, if Cuba had accepted capital inflows equal to roughly five percent of its GDP, which is standard for many developing economies. So in other words, they would have received 25 billion; they actually received 3.5 billion. That's to say the Cuban economy, because of its policies largely, forfeited \$20 billion over the last 10 years. Twenty billion dollars would be roughly 2,000 per Cuban, or \$8,000 forfeited per Cuban family.

Why hasn't more money flowed in? Investment appetites have been inhibited by an ambivalent business climate, a tortuously slow, opaque official investment approval process, and by, let's say, an elastic legal framework. Other additional barriers -- extraordinarily high taxes on labor and a very highly distorted dual currency system, which very much complicates calculations in the investment process.

Given those obstacles though, nevertheless, some firms have, in fact, invested. Why have they invested? Basically, foreign firms are attracted to Cuba for three big reasons. One, natural resources. Abundant natural resources, really. Just the tropical vacation destination in the Caribbean; deep water ports -- the Port of Havana which features on the cover of the study; some valuable minerals, nickel and others; and pretty good soil. So natural resources. Secondly, a well trained, relatively inexpensive labor force, if it weren't for the high government taxes. And three, there's a protected domestic market, 11 million people, modest size, but potentially, a geographic location. Cuba, of course, could be a platform for exporting into particularly the southern United States.

So natural resources; competitive labor costs; and markets, domestic and international. Based upon that, firms do make money today, and at the same time when you talk to them, they are doing okay today but they also are clearly positioning themselves to the future, the investable future when sooner or later U.S.-Cuban relations

normalize.

I draw most of these conclusions from seven colorful case studies, and I urge you to read them at your leisure in the report. Let me just give you a little tease, okay? I don't have time to really go in-depth into the seven, but two success stories that I talk about. Habanos Cigars. When you go down there, I urge you to do an interview at Habanos Cigars, because they are very generous with sharing their products with people that are talking to them. It's a fun place to go. Habanos is a joint venture between the U.K.'s Imperial Tobacco and the Cuban Tobacco Company. They generate revenues of about \$400 million a year; 55 million in profits, which they split between the two of them. Habanos is a very important marketing tool for Cuba. They report steady, steady growth in sales, you know, mainly to Europe. They say that targets are set. The joint ventures set targets in negotiations with the government officials. They meet those targets in sales, in profits, and in investment levels.

Still, but what's the motivation for Imperial Tobacco? For Imperial Tobacco, this is \$400 million. That's small compared to their global sales of \$47 billion. So why would they really care? Well, one thing is prestige. You know, Cuban cigars are the world's best, and you know, I always find in talking to CEOs, never underestimate the prestige factor. They like to be associated with prestige products. But they consider the goodwill of the Cuban cigar venture. They value that on their books at half a billion dollars. So that is also a positive.

So they're doing okay and they're looking to the future. And they indicate, still today, by far, the biggest market for consuming cigars is the United States. They are ready to go. They have their investment plans. They've got money allocated. So the day when they finally do get access to the U.S. market, they're ready to quickly ramp up and sell at what they assume would be premium prices in the U.S. market.

Okay. So that's Habanos Cigars.

Then briefly, looking at another tobacco company, Brascuba, which is with Brazil, the Brazilian cigarette company, Souza Cruz, which in turn, itself, is a subsidiary of British American Tobacco. They have a virtual monopoly over cigarette sales into the hard currency, or those of you who know the Cuban economy, the CUC market. They're doing pretty well. They are somewhat frustrated by some of the government controls and regulations, particularly price controls. The government is sensitive to the price of cigarettes. And so it has kept the price tight. And that's limited their profit margins. That's limited their capacity to invest further.

Also, like all the joint ventures, Brascuba is under pressure to export more and import less. So they are planning, for example, to substitute domestically manufactured filters for imported ones. They already export to over 10 countries, and they recently announced plans to actually sell their cigarettes, made in Cuba, back into Brazil. And I really rather doubt that was their first choice, but I think the government sort of persuaded them to do that.

From my visit to the factory there, their middle management seemed really quite enthusiastic, proud to be associated with an international grand, proud to be associated with maintaining global standards and production and quality. Still, they consider motivating talent and maintaining talent difficult because the government sets wages in a very narrow band, and the government accepts those wages across the economy and across joint venture. The emphasis on equity is still very much there today in Cuba on wages. It's a remarkable opposite of what you see in the United States today in which there's this huge gap in wages. Cuba is still very, very compressed; the other extreme, which makes it difficult to use wages as a motivating incentive.

One note of interest, Brascuba estimates that U.S. sanctions of various

sorts raise their cost of doing business by about 20 percent. So significant, but not so heavy as to deter their business and their profitability. So those are sort of two success stories of Habanos Cigars and Brascuba Tobacco.

From those two and the other case studies, I draw some lessons in the report about what is life like for foreign capital under central planning. And just to mention a few of these lessons, there are significant advantages, actually, as well as disadvantages, to working within the Cuban socialist system. On the positive side, you know, once you're in there, very often the government, in effect, gives you a monopoly market position or at least a strong oligopolistic position because your market presence and everything else -- prices, wages, investment levels -- are set in a political bargaining process, not a market mechanism. So in that marketing process, essentially, when you add it all up, you have pretty well guaranteed profit measures barring any sudden shocks.

And that's, you know, for a business, that's not a bad position to be in. Also, the economic environment is relatively stable. So actually, given the sort of monopolistic position, there should be plenty of time for those lucky executives to play golf, if only there were a number of golf courses.

So there are positives of working in the socialist planning model. On the other hand, there are lots of down sides. I think Diego Ruiz will go into that at greater length perhaps. The labor contract system is clearly a big headache. The one that firms emphasize, you don't hire the workers yourself. They're hired through a government agency, and wages are largely set by those government agencies. And there's a very, very implicit tax on labor.

Other common complaints you hear about operating in Cuba -- price controls, that therefore they set your profit margins; there's state interference with the whole supply chain because so many of those firms are actually directly or indirectly

controlled by the state; and then there can be different priorities between -- these are all joint ventures -- different priorities between the Cuban firm and the international company.

So on balance, I conclude there's no doubt that foreign firms -- they would be willing to invest more, much more in Cuba if Cuban markets, domestic and international, were to expand, and if the investment climate were to improve. U.S. sanctions are a cost of doing business and not necessarily prohibitive. But nevertheless, the lifting of sanctions, and most importantly, access to U.S. markets as an export market, that would definitely be a game changer.

So changes in the air in Cuba now, but on the issue of foreign investment I would say, the outcome is not clear. We don't know for sure. It seems to me that within the Cuban government there's a sharp debate going on between the skeptical orthodox factions that drag their feet, that let potential projects sit for years, and then there are more energetic reformists that recognize the imperative of further opening the economy, including to foreign investments.

Most recently, foreign firms do report some promising policy changes from their perspective. The government is permitting some firms to reduce staff, excess staff, to place more weight on labor productivity as opposed to employment security. Other welcomed innovations include authorities being allowed to hire some part-time workers, and firms also allowed to source input directly from local suppliers, including from agricultural cooperatives. Firms are pleased at those reforms.

On the other hand, on the other side of the ledger, there are some steps that could be seen as making investment more difficult, more complicated, more uncertain. And these are the downside issues that I'll report in just two other case studies that I'll mention to you briefly. One is Unilever, the great British-Dutch firm. Its

factories, you see them everywhere you travel in developing countries. There's always a Unilever factory there. They're also known for good, corporate citizenship. They win lots of CSR awards. They produce basic products that we're all familiar with, like Luck soap, Pepsodent toothpaste. In the United States, they own Ben and Jerry's, Dreyer's. I don't see those in Cuba quite yet because ice cream of quality is reserved for Nestle, and in typical Cuban fashion, these markets are neatly divided up to avoid competition.

For Unilever, again, Cuba is a tiny market. Why would they care you might ask yourself? Why are they interested? Well, there's the first move advantage that I think they may have in mind looking to the longer term. Also, companies like Unilever, they just want to be everywhere; that's just their ethos. If you were to ask them, why? Well, if we're not here, our competitors will be here, and so we would lose market share. Anyway, that's just the way they view the world. They want to be everywhere. And by being in Cuba, of course, they have a jump on their competitors, which are Procter and Gamble and Colgate-Palmolive, which, of course, are excluded by U.S. sanctions.

But the Cuban authorities it seems are no longer sure that they want Unilever to stay in Cuba. The contract is up for renewal; it's being negotiated. The original contract was 50/50. Now, the Cuban government is coming in and saying we want 51 percent. That one little percent. That's management control. And Unilever's policy, globally, I gather, is like, "No. We don't do that. Among other things, we're concerned about the sanctity and the quality of our brands."

Also, the government is saying they want Unilever to export 20 percent of their product, but Unilever sees its Cuban facilities as okay for Cuba but not competitive internationally for the various reasons that I've discussed, and therefore, it wouldn't be profitable for them to export. So right now negotiations are ongoing; have been ongoing for a long time. Of course, all very secretive, but the best that one can see

is maybe Unilever may be playing for time, hoping for a more favorable turn in Cuban law or Cuban attitudes towards foreign investment.

And the other, the last case study that I'll mention, Rio Zaza. This is a lot of fun. This is a great study, a great case. This fellow, this real character, Max Marambio, a Chilean, he was a member of the Socialist Party as was his father in Cuba. When he was a teenager, he was picked up by Fidel personally, trained in security measures as part of Fidel's personal security guards. He returns to Chile. He works with the Yenda government. He comes back. He has lots of political connections. He parlays these into business ventures, including Rio Zaza, which you see throughout the island. Their products, they're fruit juices. Really very tasty, good quality fruit juices.

In 2009, when the Chilean president, Michelle Bachelet visited Cuba, where did they hold the state dinner? In Max Marambio's villa. That tells you how well connected he is and how flamboyant his lifestyle was. The very next year, the government turns around and arrests his associates and argue that he and his firm were involved in all sorts of corrupt practices and seize the factory. Fortunately for him, he was in Chile at the time so he's just in absentia, but his business associates are serving long jail sentences.

So these two last cases that I mentioned, Unilever and Rio Zaza, they have royaled the foreign investment community in Havana. They asked themselves how stable are the rules of the game? How secure is any firm's right to operate? As one senior executive actually located here in Washington, who works for a multinational not in Cuba, of course, because it's U.S.-based, but he said, "Look. From our foreign point of view, we follow Cuba closely because we know eventually we will be there, but today in Cuba you seem to be very welcome in the morning, but in the afternoon you may be in jail." So those are some of the difficult cases that we see.

Okay. So to wrap it up, let me move on based on -- since this is, of course, a Brookings study, so we have to end with policy recommendations. Right, Ted? Some recommendations, mostly oriented towards Cuban policymakers, but some ideas for the international financial institutions and also for U.S. policy. Most importantly for Cuba, Cuba needs to overcome its animosities and fears and reach a national consensus that as a small island economy, its economic future depends upon a healthy engagement with the international economy. The Cuban government needs to send clear signals, including to its own bureaucrats, that it has moved beyond ambiguity and towards a reasoned appreciation of the benefits that foreign investment can bestow.

And as many other product nations have discovered, it's possible to accept foreign direct investment without sacrificing national sovereignty and, in fact, not only without sacrificing governmental capacity but actually enhancing governmental capacity because foreign direct investment, if properly channeled, of course, in my report, does go into the issue of what sorts of policies the Cuban government can adapt to maximize the benefits that they receive from foreign investment. But foreign investment can enhance, in fact, national capacity for policymaking and national sovereignty.

I suggest that Cuba should examine other case studies. I look closely at Costa Rica, where foreign direct investment has added about five percent to GDP each year over the last 15 to 20 years, or roughly \$2 billion a year flowing into Costa Rica. And that's with a population half the size of Cuba. In the Costa Rica case, foreign direct investment has made a huge difference in investment rates, in exports, in job creation, in adding a sense of dynamism, of optimism, of opportunity to the economy of Costa Rica.

So to begin to gradually improve the investment climate I suggest -- I'll mention just four of the suggestions here; there are others in the report. One, the Cuban authorities should complement the 2011 reform guidelines with a coherent national

competitiveness strategy that includes a prominent role for foreign investment. In designing this forward-looking strategy, the Cuban government should consult with existing joint venture executives. Secondly, the Cuban government needs to completely overhaul the investment approval process. They have to make it much more transparent and much, much faster. Third, they should build on the success strategies with Habanos, for example, with Peignoir Ricaud on rum distribution on a worldwide basis, and do that with other products as well. Most notably, pharmaceuticals. Up until now, the Cuban government has hesitated to form joint ventures with European or other pharmaceutical companies, but those pharmaceutical companies are marketing engines, and that's what Cuba needs if they're really going to sell their patented pharmaceutical products successfully on global markets.

And then the fourth thing I throw out there is that the Cuban government needs to sharply reduce the implicit tax on labor. That would benefit Cuban workers. It would benefit the competitiveness of the economy. They would have to make up for that with other taxes. They are moving ahead with fiscal reform, which would give them other sources of revenue to balance off the loss from the labor tax. So those are four ideas that I throw out there.

I might also mention just briefly that the recent news about Hugo Chavez just emphasizes the point of how important it is for Cuba to diversify its sources of international finance. Right now, Cuba may be receiving something between \$2 and \$4 billion a year in subsidies from Venezuela. Even if that doesn't end abruptly, we can imagine in the future that would probably be gradually reduced, phased out, or phased down, at least, and that Cuba will need to have to therefore diversify its sources of international capital.

Building on my previous report which looked at the role of the

international financial institutions, this report repeats the idea that the IFIs, and now perhaps -- now that the elections are behind us in the United States, the administration can take a new look at some of these issues, including the possibility of the IFIs beginning gradually to reintegrate Cuba beginning with technical assistance. The IMF, World Bank, Inter-American Development Bank can help Cuba to design its new national competitiveness strategy, draw on the experiences of other economies that the IFIs are very familiar with, such as Costa Rica, and help Cuba think about, among other things, how to access the various markets, the supply chains for tourism, nickel, sugar, biotechnology, et cetera. The IFIs can help Cuba take advantage of its important advantages in human capital, natural resources, and market location.

There are a lot of good economists in Cuba. The IFIs can work with those Cuban economists to take a really good, hard look at the overall business climate and think about ways to design a realistic and sequenced set of corrective measures. So some ideas, other ideas, are also in the report for reform of the Cuban economy.

Very briefly, for the United States, the reelection of Barack Obama opens the door, I hope, to a thorough review of the Cold War Era sanctions. As the United States does routinely -- routinely worldwide, most recently in Myanmar and Burma -- U.S. policies engaged to see to accelerate positive change, albeit in authoritarian political settings. That's what we do everywhere; normally, that's what we should also be doing in the case of Cuba.

To begin, the United States should not stand in the way of Cuban access to policy advice and training from the international financial institutions if Cuba expresses interest. The Obama administration can build on its liberalization of remittances and travel to further facilitate assistance to the emerging private sector in Cuba. The administration should boldly lift sanctions on commerce with firms certified as private

business or independent cooperatives.

So to wrap it all up, external players, such as the United States, can bolster local reformers in places like Cuba, but the main thrust, as always, must come from within Cuba. Cuba needs to appreciate the major contributions that foreign investment has already made to its economy, and Cuba should recognize that foreign investment, far from being a threat to the regime's social accomplishments; rather international capital offers the best hope for preserving the social gains of the revolution but within the context of a more competitive and more prosperous national Cuban economy.

Thank you very much for your attention.

(Applause)

MR. PICCONE: Thank you, Richard.

I think you get a flavor of just how deep some of this analysis went, and I hope you will take the time to look at the report.

I'm now going to turn to Diego for some comments.

MR. RUIZ: Thanks, Ted.

Good morning. It's a pleasure to be here, and I just want to say at the outset, offer my congratulations to Richard on a fine report. I think, Richard, you've done a fantastic job with very challenging circumstances and limited information in capturing what I think truly is going on in Cuba right now with respect to foreign direct investment. And having just returned from a delegation trip to Cuba a couple of weeks ago, I can echo in an anecdotal manner a lot of what Richard has laid out in a more scholarly way in his study and some of the specific points that he's just itemized for us just now.

Let me tell you a little about this most recent trip to Cuba, the purpose for it, and then I'll just talk a little bit about what we saw there from a business perspective.

As Ted mentioned, I am an employee of a major multinational corporation, so the lenses through which I'm looking at the phenomenon of change going on in Cuba right now is from a business perspective. So I'll share perhaps some observations on what the future might hold in the near term in Cuba for business investment.

I am on the board of the Council of the Americas, which I'm sure a lot of you are familiar with, but it's basically an organization comprised mainly of businessmen and women, not just from the U.S. but from throughout the world and the hemisphere. And the purpose of the council is to create links between business and governments in the region. And so we went, about two weeks ago, on a small delegation to Cuba, an official delegation, put together -- our agenda was put together by the Ministry of Foreign Relations, and we met with several fairly high-ranking folks within different ministries of the government -- the Ministry of Foreign Relations, of course, but also Ministry of Basic Industry, Ministry of Tourism. The state agency for biotech and genetic engineering, the sugar trade group, which used to be a ministry but is now a state-run trade organization for all intents and purposes, and a handful of others.

It was a fascinating trip. It was my third trip to Cuba. I've been on two other occasions, in '07 and 2010. And so, for me, in particular, it was a great opportunity to see what kind of developments are taking place in Cuba in that short period of time but also a period of time that straddles the beginning of some of the loosening in economic restrictions for Cuban people and for foreign companies.

In a nutshell, I think it's fair to say that I saw a lot of changes taking place. I saw big differences between this trip and prior trips that I've taken. A lot of positive change. And so, you know, I'm not going to tell you anything you haven't been reading in the newspapers and seeing in the news, but there is a sense of openness that is markedly increased from my prior trips. There is activity that is admittedly hard to

quantify but it's still palpable. You can see economic activity going on. You can see every day Cubans going about their business in ways that they weren't allowed to do in the past, and all of this, again, from a purely anecdotal basis, contribute to what I sensed is a new dynamism that is starting to be seen.

Of course, the big question is how quickly might this progress? Will it progress? Will it be allowed to progress? Is this a foundation to be built upon or is this something that can be reversed just as easily as it was initiated? And I think that is obviously a key question going forward. I will say that although I have an overall sense of optimism based on what I saw, and I think it's safe to say the entire delegation did as well, I don't think we saw anything that is irreversible. So there was nothing that we could see in terms of either the specific policy measures that have been instituted over the last two, three, four years, or the effects of those policies on the ground that we could point to and say this is change that has taken hold, that is planting deep roots, and cannot be turned back. It could be turned back, and I think given the history of Cuba, one big area of concern is that at various points in time when there have been green shoots of liberalization, we have seen retrenchment as well. So I don't think in sum that there's anything inevitable about the direction that the Cuban economy or Cuban society has taken. But again, having said that, I think overall a positive outlook in terms of what we saw.

Now, what specifically? Again, I mentioned the increase in economic activity at the basic level. That flows directly from the recognition of the Cuban government that it cannot maintain such an incredibly large public payroll, and the conscious decision of the government to, in essence, emancipate hundreds of thousands of Cubans from the state payroll and open up areas of economic activity to them that have previously been closed. And so you see the (speaking in Spanish), in essence,

self-owned businessmen and women who, you know, in some instances might be nothing more than a vegetable stand or a shoeshine business or a (speaking in Spanish), a home-run restaurant, but these are real. They employ real people. They provide salaries and provide benefits. And so that is definitely a big positive.

Those types of activities, I don't think have any real hope of lifting the Cuban economy above a certain point, but they do serve, I think, as kind of a canary in the coal mine. And so to the extent that you see economic freedoms being granted to people who are striking out on their own, that can serve as an optimistic data point in the larger economic outlook, and conversely, to the extent that those folks are being squeezed or there's a retrenchment in those policies of openness, I think that also can serve as a canary in the coal mine for larger corporations and bigger investments that are looking at the island.

Another very positive factor that we saw while we were down there is what I think is a newfound openness about the problems that ail Cuba and the steps, at least some of the steps that are going to be necessary to lift the Cuban economy and to keep it moving forward. And I don't think that's to say that there's absolute consensus, but I found remarkable consensus in the fact that there's a great, great need for foreign investment. There's a great need for modernization. There is a need to remove additional restrictions from private economic activity. And again, that's not to say that, you know, the Cuban government, or even Cuban society as a whole, has rediscovered Heich and Friedman by any means, but it's certainly the degree of openness with which people speak about these kinds of issues and the relative consensus on what is needed I found refreshing and it's something that was new to me from prior visits. And that was something we saw, especially among economists. We had some very good sessions at the University of Havana's Center for the Study of the Cuban Economy, very, very sharp

economists who, as much as anyone, have access to the real facts and figures of what's going on in the economy and, I think, have a very fresh and refreshing outlook on policy prescriptions for the Cuban economy going forward.

Now, we also saw a lot of negatives. So let me tell you a little bit about those. First of all, the steps that have been taken to open up the economy to the extent that it has been are relatively modest so far. And so, you know, we're not talking about unfettered capitalism here. We're talking about very specific and modest steps to open up certain parts of the economy and maintain restrictions on many, many others. Secondly, I would say there is a mixed record so far -- it's early -- since the guidelines put out by Raul Castro and ratified by the Communist Party. And I think it was in 2009, if I'm not mistaken, but if you peg that as kind of the beginning of this new openness.

There's a mixed bag of results from that. You have agricultural production, which is mixed. It's been down a couple of the years since then. It's been up a little recently. Prices have gone up, as you would expect in any sort of more liberalized environment because you have greater freedom for limited resources to chase limited goods. And so there's not necessarily a great deal of successes that you can point to and rally public opinion or consensus with examples of unmitigated successes.

The Cuban government, I think, has put a great deal of hope on the prospects of oil exploration and oil reserves in the territorial waters around Cuba. They estimate that there is somewhere around 20 million barrels -- 20 to 25 million barrels is the figure that we heard. Parenthetically, the U.S. Geological Service thinks it's somewhere between 5 and 10 million. But whatever that number is, there have been a lot of expectations placed on that. And while we were there, unfortunately, the last European funded joint venture in oil exploration was basically packing up its bags and going home, and they've had very few finds, and what finds they have located are

apparently not suitable at a reasonable exploration cost. They're not suitable for deep sea drilling. And so things like that just kind of temper any sense of optimism I guess that you might have.

There is also, because the opening has been relatively limited, you have distortions that are created which I think are natural anytime you try to be just a little bit pregnant, I guess, I would say. And so opening up in certain areas but continuing to clamp down in other areas creates distortions which are visible in society and either are having, or I think will have, an impact down the line that is not at all healthy. So you have situations, for instance, where different types of investments or economic activity are favored over others and they create distortions and contradictions that are kind of hard to square, especially with a revolutionary philosophy that is the underpinning of the Cuban government.

So, for instance, the use of agricultural land has been opened up in recent years for farmers to work and (speaking in Spanish), basically to reap the benefit of their labors. But they get the lease of the land they work for only 10 years. At the same time, the Cuban government is exploring tourism developments and golf resorts with 99-year leases. It's just kind of hard to square those types of things. You have situations where -- well, you have very -- what seems to be very rapidly growing inequality, which for a country, socialist country like Cuba, has got to be a very tough pill to swallow. So the figures we heard from the economists at the University of Havana were that around the late '80s, before the collapse of the Soviet Union and the beginning of the (speaking in Spanish), the Gini coefficient in Cuba was around 0.25, which is, you know, right up there with the Scandinavian countries in terms of income equality and a pretty good ranking as far as measures of inequality goes. Apparently, it's up to about 0.42 according to these economists right now, which puts it not that much -- not very far

away from the United States and other countries where income and equality is significantly higher.

And so you have a situation where certain people are significantly favored over others in Cuban society, not because of any differences in merit or level of education or formation, but simply because of their place in society. If you work in the tourism industry, you're getting dollars and Euros in tips. If you're working in a state-owned enterprise, you're not. In fact, you're getting paid in nonconvertible pesos by the government, which receives convertible pesos from the foreign investor, and the government gets the advantage of a 25 to 1 conversion rate.

And just to wrap up, I think there are inherent contradictions that are caused by a partial opening that are going to have to be sorted out. And if they're not, the danger, of course, is that you have a situation with low growth, low investment, and rising inequality in a country that does not necessarily have the wherewithal to face those types of challenges.

And I'll wrap it up there and leave it to the discussion for the rest.

MR. PICCONE: Thank you very much, Diego.

I think what we heard is a very kind of up-to-date perspective on the situation from -- at least from a foreign business perspective and an academic perspective. I would add to the negative developments. Recently, of course, Hurricane Sandy was a pretty major blow on the island, particularly on the eastern side, particularly in the coffee and sugar industries. So it's another factor in kind of the hole that they need to climb out of.

I want to say just very briefly one or two words before we open it up to some questions and answers, which is to turn the focus a little bit to the role of the United States in U.S.-Cuba relations. We are on the threshold of a second term for the Obama

administration, and President Obama did lead early on in his first term with some important changes in travel and remittances, in particular, allowing Cuban-Americans to travel freely to the island to visit family, to send as much money and gift parcels as they would like. And that community has responded very generously, proactively in taking advantage of those opportunities. And this has inserted a lot of capital into the economy. It is helping some of the small business sector get that restaurant opened or open a small shop. So I think we should emphasize that on the U.S. side it has not been static. There is a positive step in that way, in a very concrete way to the Cuban people.

On the negative sides, pretty much since then any further progress has been frozen largely because of the arrest of a USAID contractor named Alan Gross -- I'm sure you've heard of this case -- which is getting a tremendous amount of attention lately. And I don't know if anyone has been noticing, but the U.S. Senate just adopted a resolution condemning the arrest, calling for his immediate release. Secretary Clinton has just issued a videotape Q&A in which she calls Alan Gross a political prisoner. The U.N. working group on arbitrary detention has declared the detention of Alan Gross to be arbitrary and that he should be released. And folks here in Washington, particularly on the Hill who were moderately open or friends of a new approach to Cuba, are starting to turn away from that position. And so I think the pressure is really on Cuba to start looking differently at this case.

Up until now it's been a matter of trying to get a swap going with five Cubans who were arrested in the United States and tried on espionage charges and have in some of those cases very long prison terms still to serve. And this has been tabled for some time now as a possible exchange, which I think for most of us who have worked in the U.S. government and understand the way our legal system works, it's really not in the cards. And Secretary Clinton made that very clear in her last interview.

So I think the pressure is on to come up with some new formulas to get past this case. I think both governments recognize that they've dug themselves into a hole, painted themselves into a corner and need to get out of it, and the economic opportunities probably provide a way out of this dilemma because I think if you look at it from the point of view of traditional U.S. policy of trying to support change in Cuba, the economic reforms are really an effort, a possibility to empower the Cuban people to become more independent of the state. And this is certainly within U.S. interest, proclaimed interest.

So I think there is an opportunity given the state of the Cuban economy and the assistance that they need, and the United States' own policy goals in supporting the Cuban people, to set forth a whole set of steps that the president could take under his executive authority, would not require congressional action but would allow the president to set forth a number of measures, for example, supporting the small business community by allowing U.S. businesses and citizens to interact with them directly through technical assistance, through pooled remittances, through actual trade that we could buy products from companies, small businesses that are certified to be small businesses independent of the state. There are a number of things that could be done to support that sector and have ramifications more broadly for -- positive ramifications for our policy goals. So I wanted to mention those ideas as well.

And I have a question for both of you before we open it up. There's another issue that's kind of stuck on the U.S.-Cuba policy agenda in some people's minds, which is the issue of unresolved property claims. And I was wondering from a foreign investor's point of view whether you're an American or foreign company, whether that is considered an obstacle or a negative factor in trying to evaluate whether to invest in Cuba.

MR. RUIZ: My sense is it's a factor, and I'm again speaking for a particular company, so I don't have the perspective of the broad investment class. It's a factor, but I would say from my perspective it's a factor more in terms of the potential legal risk created by the Helms-Burton Act than anything else. I don't know that it's as much a factor for unresolved claims of particular investors seeking to get back into Cuba and somehow having to resolve claims on their property. I defer to others who are in that particular category who might have a different perspective.

I think one significant issue is the chill that is cast upon foreign investment by the risk of litigation because U.S. law basically creates legal risk for anyone that goes into Cuba and makes use of property that used to belong to a U.S. entity and is in dispute. And my understanding of U.S. law is that that applies as well to non-U.S. companies doing business. And so that is something that I think has to chill over -- yet another potential chill over the prospect of foreign investment in Cuba.

MR. FEINBERG: Well, typically the way these types of problems are resolved, for example in Eastern Europe, in Nicaragua, when you have this sort of reversal, is that there's a government-to-government negotiation process to sort of clear things up. If you left it case by case, you know, these things would just drag on forever. I don't think it's too soon for the United States to begin to sit down. There has been a process whereby people with claims to the United States registered back in the 1970s. So there already is some groundwork. I don't think it's too soon for the U.S. government to begin to sit down with foreign investors and take a look -- to begin to think about how this problem would be resolved in a government-to-government eventual negotiation. It would be part of a process of normalizing economic relations with Cuba.

MR. PICCONE: Well, if we have any questions, this would be the time. Let me call on Alfy Fanjul in the front. There's a microphone coming.

I want to acknowledge both Ambassador Paul Cejas and Alfonso Fanjul, who have been great friends of the Brookings Institution, accompanied us on a trip that our trustees and other friends took to Cuba last April, and will be bringing another delegation down in February.

Alfy.

MR. FANJUL: Well, first, I'd like to congratulate Richard and Ted and Diego for the exposition each of you have made I think have been very good. Sometimes dour, sometimes optimistic, but I think it was very well balanced.

I guess my question is, at this stage, first of all, what do you think about the diaspora and their role in the future of Cuba? And secondly, do you have any specific -- if you had to make two or three recommendations, both to the Cuban government and to the United States' government of potential changes within the core framework of relationships, what would those be? Thank you.

MR. FEINBERG: Thanks very much. And I very much appreciate your comments on the report.

There is in the report a brief section that does deal with the issues of the role of the diaspora, which clearly can be quite important. There are many historical presidents of diaspora playing a very important role in the development of the home economies, and Cuba clearly will be an important case. Already, if you look at the paladares and the other small-scale retail outlets, et cetera, they are opening up in Cuba, the self-employed, if you ask them where does your investment capital come from, well, a few of them worked abroad and saved some money, but the ability of people in Cuba to actually save money is very, very limited. And of course, there's virtually no access to bank credit.

So where do these folks opening these restaurants or these bed and

breakfasts or small-scale repair shops, where are they getting their money from? Miami, of course. But how is this done? It's done in ways which you can't do a formal investment, right? So this has to be sort of, you know, it's just oral agreements as to what form this transfer is taking. Is it understood as an investment? Is it merely a donation? Et cetera? So I think there's a lot of reasons -- it would be valuable, both from the Cuban point of view, as well as the families involved, to think about making more open and legal and formal ways in which Cuban-Americans could transfer funds to support investment on the island.

Then, as Ted suggested, if a firm is private, operating in Cuba, why shouldn't it be exempt from sanctions? Why shouldn't they be allowed to sell their products into the U.S. market and also receive investment and trade flows openly and legally from people in the United States, particularly Cuban-Americans, the diaspora that care to support them? This is what we would do worldwide in any other country. There wouldn't be any question. The United States would encourage interaction between Americans, certainly diaspora, and the private sector in that economy. As Ted Said, it would be seen as a way to support folks that are operating in the private sector relatively independent of their state. The growth of civil society. That's what the United States espouses. That's what the United States does worldwide. Why should Cuba be an exception?

MR. RUIZ: I would completely agree with Richard's assessment. I think the diaspora is a very big force in the Cuban economy right now and has been growing. In some visible ways and in some not so visible ways. The opening up of people-to-people contacts and family-to-family contacts has been a great part of that, but as Richard just said, so much of the capital needed to fund the economic development that's taking place right now to the extent that it is coming from Miami and from New Jersey

and from Cubans abroad. It's coming from Cubans who are back on the island after a period of time abroad where they were able to save actual hard currency and come back and invest it in the country.

One thing that I saw a significant change in is the amount of renovation and fixing up of old homes in Havana. Now, that's not to say the job is done or anywhere close to it. It's still a city that is oftentimes crumbling before your eyes, but I saw a lot more and talked to people who have undertaken renovations of homes, beautiful homes that are now looking good. And the money is hard to come by on the island. It's coming from outside of the island.

Again, I think this creates some great opportunities, but some great contradictions. Just as if you're a Cuban national working in, say, the tourism industry or working for a foreign-owned JV, you have access to hard currency and are living at a significantly higher standard of living than the average Cuban. If you have relatives in Miami, you are also enjoying a significantly higher standard of living than if you don't. And so that creates some big divisions between the folks who have a relative abroad who tend to be of a different class and those who don't.

So the one area, of course, where the Cuban diaspora cannot currently make a difference is in significant large-scale investments beyond sending money home to relatives. And of course, there's only so much you can do to grow the Cuban economy through (speaking in Spanish) and things of that sort.

MR. PICCONE: I saw a number of hands. Why don't we take two or three questions at this point? We'll start in the back and come forward. If you could identify yourself. Thanks.

MR. GREWE: Hi, I'm Chris Grewe. I'm with the U.S. Department of Treasury.

As all of you have noted, there has been some marginal relaxation in the Cuban economy, but the government still controls what I'd call the medium heights of the economy, so wholesale markets and distribution channels and things like that. And these are controlled by state-owned enterprises, ministries, who have clear vested interests in their control over that. So I've got sort of two questions related to that. One is how does the government -- what's the recommendation to the government for releasing, relaxing that kind of control? And secondly, we've seen this kind of transition in Eastern Europe and the other former communist countries. And are there lessons for how to relax government control without them leading to oligopoly capitalism or state-owned enterprises, just simply shifting into private hands rather than continuing to be part of the government?

MR. PICCONE: Great. Let's take a couple more.

MR. RIOS: Aimel Rios, National Endowment for Democracy.

I was wondering if in your report or in your recommendations you would actually recommend a foreign direct investment mechanism? Because what exists right now is not direct investment. Investment done through joint ventures is not really a foreign direct investment. Is that something that you would recommend for the Cuban policymakers to consider allowing companies, foreign companies, to actually directly investing in the Cuban economy? And secondly, if in your -- I'd be interested to hear if in your conversations with the leaders of the foreign investment community in Havana, the issue of social corporate responsibility came up at some point. You did mention a foreign company that is very proud of its CRS standards and what is their take on the Cuban investment scenario, vis-à-vis their ability or lack thereof of applying corporate -- international corporate social responsibility standards? Thanks.

MR. PICCONE: Let's take one more. Wayne, up front here, please.

SPEAKER: Thank you. Back to the stalemate in which we now find ourselves with the Alan Gross case. There is growing pressure on Cuba to release Alan Gross. And good; we all want to see him released. But there's going to have to be some kind of *quid pro quo*. And of course, not the Cuban 5 for Alan Gross; that's not going to work. But what about some kind of economic arrangement that the U.S. would come up with to facilitate engagement as the *quid pro quo*? They want to increase trade, economic relations with us, and this would work in that direction. Isn't there some -- so far it's really disappointing with the United States insisting that Alan Gross be released or there won't be any movement, there won't be any improvement in U.S.-Cuban relations. But you don't see the United States making any effort to come up with some *quid pro quo*, some arrangement that would lead to his release. We need to do that, but we can do it in such a way that would facilitate economic relations between the two, if would seem to me.

MR. FEINBERG: Yeah, terrific questions all around. Maybe I'll leave it to Ted to mainly handle the Alan Gross question.

I would just say one thing though. The Alan Gross, the whole affair reminds me of the child's fairy tale about Brer Rabbit and the Briar Patch. And the idea behind Brer Rabbit and the Briar Patch is that he says, "Please, please, anything, anything, but don't throw me into the briar patch," which is exactly where he wants to end up, of course. And so he does some naughty things and sure enough, his antagonists throw him in the briar patch and he's so happy. And these are the hard-line Cubans who look for ways to freeze U.S.-Cuban relations. And in this case, Alan Gross is the guy they threw into the briar patch and the Cubans say, "Oh, please, please, don't put sanctions on us. Don't put sanctions on us," when, of course, that's exactly what they want to have happen. They want to freeze U.S.-Cuban relations, a faction of the Cuban

government. And we, time and time again, fall into that briar patch paradox trap. For psychological reasons, it's understandable, but we ought to see through that, and we should act on the basis of U.S. interests, a clear view of U.S. interests, which we seem to so quickly lose sight of. I'll leave it to Ted to respond to the specifics.

Very interesting questions about economics. Chris from the U.S. Treasury, on this issue, of course there are lots of historical experiences that we would hope the Cuban government will be able to draw on to do what others did well and to avoid many mistakes that were made particularly in Eastern Europe. And what's the best repository? What's the best archive of those experiences? The international financial institutions. And which government agency in the United States is primarily responsible for setting policies towards the international financial institutions, Chris? The U.S. Treasury Department. So I very much hope that the U.S. decides that it would be in everyone's benefit to allow the Cuban government to benefit from the accumulated wisdom in the international financial institutions that have spent a lot of time thinking about these issues of transition.

In the Cuba case though, unlike you see in Europe, so far anyway, no one is talking about privatizations of existing state-owned companies. So that, at least right now, is not on the agenda, which is what occurred in the Eastern European case. What seems to me to probably be happening is that the state-owned enterprises will gradually over time be given more and more autonomy and they will gradually begin to function like let's say state capitalist enterprises operating under certain regulations and restrictions. And that's where the really interesting action will be down the road. And some of these -- many of these companies I think will eventually form joint ventures. They may sell stock or whatever. So I think that's what we really should watch and focus on.

There is a major reform going on now to try to remove the power from some of the ministries and move it into what look like essentially holding companies, which seems to me is sort of a way to begin to give these larger firms more independence. Yes, the large distributors, everyone in Cuba, of course, complained about them for years as causing all sorts of headaches, being inefficient. The big problem now with the agricultural coops that are generating more product, there aren't enough trucks to sell those products because the state-owned distribution companies are inefficient or don't have the capital, so people are looking for ways around that. Allowing cuentapropistas to set up trucking companies, real companies with large capital stock, I think they are, in fact, moving in that direction.

Briefly, the question on -- foreign investment now, it is real foreign investment, although in the form of joint ventures, but that still counts as foreign investment under all definitions of foreign investment. The foreign investment law, law number 77 from 1995, does allow for 100 percent ownership, although that has actually been granted by Cuban bureaucratic process very, very rarely. Should that be allowed? It is legal. Why shouldn't it be allowed in certain circumstances? That's largely, of course, a political decision for the Cuban government.

On the issue of corporate responsibility, Sherrod, the Canadian company -- you can see it in their annual reports -- is very active with a whole series of corporate social responsibility programs. In a socialist society, the question of what is the proper role, social role of a company is different than in a more free market system. Companies like Brascuba, what they consider to be relatively social, the progressive policies is, for example, having more of an internal dialogue between the workers and management. Maybe giving them better quality lunches, although the government limits the extent to which you can do that; providing transportation for the workers so that they don't have to

go through the public transportation system; things such as that. Maybe providing some scholarships for the families of the workers there.

But as the Cuban government reduces government subsidies, across the board universal government subsidies, that is where a role for the private sector really opens up. As families no longer have all of their basic needs covered by the government, then you have lots of opportunities for private firms to begin to fill that gap. So I think down the road, for the foreign sector, for the joint venture sector and foreign investors, this issue of corporate responsibility will become a more prominent and important feature of their activities in Cuba.

Thanks for that question.

MR. RUIZ: Sure. Just to touch on the point of the middle heights of the economy being still state run and state controlled, I think there is a general recognition that there needs to be more decentralization of decision-making. Now, it's episodic in nature and it's baby steps perhaps, but a big part of the philosophy, if you will, behind the guidelines put out by the government in 2009 that are being slowly implemented in fits and starts, is that ministries should, where possible, devolve decision-making authority down to lower levels, whether it's the state-owned companies or state-controlled collectives or trade organizations, or even localities. Now, one challenge is are these entities qualified to make use of these new powers and the new liberties to make decisions? And that's obviously a very big question.

You're starting to see, again, in an episodic manner, instances of kind of the middle levels of distribution channels, for instance, being open to private economic activity. In the last week or two actually, I would direct you to there's a story on MPR that mirrored a story in the *New York Times* about market wholesale -- agricultural market basically cropping up informally on the outskirts of Havana which has become this huge

market where in essence the entire restaurant industry of Havana goes to supply itself. It's informal. It's subject to reversal by the authorities, people that either shop there or go there to sell their wares are a little bit uncertain about how long they'll be allowed to do it, but again, I would file that under the green shoots and the question is can that continue?

MR. PICCONE: Well, just to wrap it up, two very quick comments. One is on the Gross matter. I think, you know, the president does have some executive authority to advance a number of measures, but one big one that he cannot do is allow tourism as such. You know, open that. That's a congressional prohibition against tourism and would require congressional action. I think we all know where Congress sits on Cuban matters these days, and you know, with the election of Ted Cruz from Texas to the Senate, it may have gotten worse, not better, although we do have a new Cuban-American congressman from Florida, which helps a little bit in the dynamic, but nonetheless, it does constrain the president. Because even if the president does exercise his own executive authority, he's going to get a lot of political heat from the hardliners in the U.S. Congress. And that is going to make him think twice, and he's going to have to spend some political capital to make that happen.

I think there's no question you can make the case under current U.S. policy and law that advancing on a number of fronts to liberalize relations within the confines of the embargo is in U.S. interests. And the economic changes are obviously the low-hanging fruit to make that case. And I think it's just a case of getting some stars aligned and getting over this Alan Gross so that can happen.

Secondly, I just want to mention that we've heard a little bit about the University of Havana in this last question about comparative perspectives and what the Cubans can learn from others. Brookings is undergoing -- is creating an experts working group on looking at the Cuban reforms from a comparative perspective from Latin

America and the Caribbean and what can be learned from the region, and we'll be doing that in 2013 and issuing other reports and doing other meetings, so we look forward to having you back. And please join me in thanking the panel for their comments.

(Applause)

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