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EMERGING ENTREPRENEURS AND MIDDLE CLASSES
IN CUBA: A SOFT LANDING?

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PARTICIPANTS:

Introduction and Moderator:

TED PICCONE
Acting Director and Vice President, Foreign Policy
The Brookings Institution

Panelists:

RICHARD FEINBERG
Nonresident Senior Fellow
The Brookings Institution

CARLOS SALADRIGAS
Chairman
Cuba Study Group

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PROCEEDINGS

MR. PICCONE: Good morning, everyone. We have a friendly crowd here and I also hope some tough questions along the way. But welcome to Brookings. I'm Ted Piccone. I'm the acting vice president, director of the foreign policy program here and for some time, even the last few years, I've also been taking some interest in Cuba. So I'm particularly interested and excited to have you all come today and talk about the role of the emerging middle classes and entrepreneurs in Cuba and what that means for the future of Cuba and U.S. policy.

You know, our work on Cuba began several years ago in about 2007-2008, when we convened a task force to look at how U.S. should re-think its policy toward Cuba in the context of the upcoming 2008 presidential elections, and we issued a series of reports and a book that Carlos Pasqual and Vicki Huddleston led.

We continue to, of course, concern ourselves with U.S.-Cuba relations and have watched that closely. But we've really been more intensively focused on the changes underway in Cuba, particularly in the Cuban economy. We are engaged in a partnership with the University of Havana and its Center for the Study of the International Economy and the Center for the Study of the International Economy in a series of workshops and exchanges to look really carefully at the scenarios for

economic growth, what's happening in the area of financial monetary reform and the dual currencies, the institutional changes that need to happen in order for Cuba to continue to grow its economy. And we will continue to work in that area. We've issued a number of papers out of this partnership that are now on our website, and there will be more coming, so I wanted to call that to your attention.

We also are very happy to be working so closely with Dr. Richard Feinberg on a series of in-depth monographs on different facets of the Cuban economy and the international response, the role of the international financial institutions, the role of private foreign investment, and with this third report on Cuba's entrepreneurs and the emerging middle class.

I think most of you know Richard, you all have the bios for today's speakers. Richard is professor of international political economy at the Graduate School of International Relations and Pacific Studies at the University of California, San Diego. It's a long title. He's also, I first met Richard when he was the senior director, special assistant to President Clinton for inter-American affairs at the National Security Council. He's had a fascinating career also at the State Department and the Treasury Department and the Peace Corps and, as you know, written a number of books and articles on a number of issues regarding U.S.

policy and Latin American affairs. We're very happy to hear from him today and I will turn to him shortly.

We will also be hearing from Carlos Saladrigas. Carlos is chairman of the Cuban Study Group, which is playing a particularly important role in, as a voice in the Cuban-American community, to talk about improved relations between U.S. and Cuba. He is the chairman and CEO of the Regis HR Group, which provides human resources services to businesses. He's a business leader in other areas as well, Progress Energy, Advance Auto Parts, Premier American Bank, Vincam Group, PepsiCo, the list goes on, and he is well-recognized for the work he's done in the philanthropic and charitable community at the University of Miami and Catholic Charities and the Jesuit School. We'll hear from Carlos after Richard's presentation, which will be a PowerPoint.

I also wanted to mention that we had hoped to have today a third panelist from the University of Havana, Saira Pons, who is on her way to the United States for some work at Harvard, but because of very typical delays in visa processing, she was not able to make it today. This is a constant problem for any of us who are working on issues relating to Cuba. The obstacles that we face in the most basic form of academic exchanges, people to people exchanges have been, as some of you know who deal with this, a major headache, and I hope this is something that

will change along with a lot of other things that need changing in terms of U.S.-Cuba relations.

Let me stop there and call Richard to the floor. I'm sorry, let me mention, well, I'll mention this at the end. Go ahead.

MR. FEINBERG: Okay, thanks very much, Ted. Great to see so many friends here on such a beautiful sunny fall day here in D.C. I want to recognize right off that we have a number of people here in audience who are really long-term scholars working on Cuba who have been, who have devoted their professional careers to try to improve our understanding of Cuba and of U.S.-Cuba relations. I would just like to mention a couple of them here. They deserve that recognition. Jaime Aparicio I see here, Phil Brenner, Bill LeoGrande, so pleased to have with us Ambassador Muni Figueres from Costa Rica. I'd also like to mention, I think Phil Peters is here, Mark Sullivan, and Sarah Stephens who has done so much work over the years to improve U.S.-Cuban relations. So we, my own work and all of us are indebted to your labors over many years, so thank you very, very much for that.

So this is the cover of my most recent report. And why did we choose to put this photograph on the cover? Because the usual image of Cubans projected in the United States is an old grumpy man scowling at us. But here we see a restaurant owner in Cienfuegos with his

bartender. These are attractive, open, welcoming Cubans, the Cuba of today. These Cubans are hip, they're modern, they could be in Park Slope or Logan Circle. And that is more representative of the real Cuba today.

I'm going to talk about a couple of main themes today.

Today's themes are, first of all, already there's a very large private sector in Cuba, by my calculations, which I'll shortly explain. Up to 40 percent of the labor force is already operating in the private sector in Cuba. This private sector that has emerged from within the Cuban state Socialist system.

Moreover, shockingly as it may sound, Cuba really is already, largely, like much of Latin America, a middle class society. And that if you sum together the private sector and the middle classes, that together will give you the two new pillars for the future of Cuba, a Cuba in which you would have a more efficient and more productive Cuban economy, of what I refer to in the paper as open market Socialism.

An historic opportunity now beckons for the United States. The U.S. can sit passively on the sidelines or it can actively seek to bolster reform and increase the probabilities of a gradual economic transformation, a soft landing for Cuba.

Now, let me go into the details of all of this, one topic at a

time.

First, in terms of the growth of the private sector, those of you that have followed Cuba know very well that over the last several years, basically since Raul Castro took over, the government has permitted Cubans to increasingly exercise their entrepreneurial talents. Now, something like 450,000 Cubans are officially registered as self-employed or *cuenta propista* businessmen. Recently the government expanded the number of categories allowed from 181 to 201. It's true that this group of self-employed does not apparently include those who showed DVDs in their homes as you may have may heard, but I want to underscore that although that was a backward step, we should not lose sight of the general trend, because just in the last few months they've expanded the number of allowed professions from 181 to 201, they have authorized a whole series of new urban cooperatives already employing maybe some 3,000 Cubans, they've accelerated that, they've announced their intention to unify the exchange rate, and they've just recently authorized the formation of wholesale agricultural markets, which is a dramatic and important step forward. So that's the broader trend we should not lose sight of.

So in addition to those *cuenta propistas*, we have a number of other areas where private sector activity is ongoing. In the agricultural

sector, we've still got, there are still a lot of farmers in Cuba who own their own plots, either individually or as cooperatives but are part of the private sector. We also have in the joint venture sector at least 34,000 employees that I would consider working in effect in the private sector, and then these new urban cooperatives that are springing up and are accelerating in their formation.

So together, these would be more or less the official numbers, we have 1 million Cubans in the private sector. That's out of a work force of 5 million, or 20 percent. But now, my innovation. I would add to that 1 million here, there are still many Cubans who are working informally in the private sector, not yet registered. And there are a number of previous studies to that effect. I estimate at least 10 percent of those Cubans who are of working age who are not officially employed or registered as employed. So that would be 10 percent of 1.8 million, or 180,000 working still in the informal sector.

In addition, a new category that I have branded here today, called GESPI. GESPI stands for government employees who earn significant private sector income, GESPI. As we know, the wages in Cuba for public sector employees are miserable, \$20 a month at the official exchange rate. Who can live on that, right? So, many government employees supplement their private income moonlighting in one way or

another. They may do that in their same profession, for example, doctors who work in the evenings attending private patients for an income, for fees, many other examples, construction workers who remodel homes of their neighbors in the evening or on weekends. And that income is, exceeds the \$20 a month they get paid in the public sector. So, hence, I consider these people already at least one foot already in the private sector.

And if you take the 4 million government employees and say 10 to 20 percent of those, at least, conservatively, are engaged in these GESPI activities, then that gives you another 400,000 to 800,000.

Plus, in Cuba, as all of you know who've visited there, how many artists are there, independent artists, people making money as dancers, as performers, as painters, as musicians? We don't know what the numbers are but it's significant. You have a lot of migrant farm workers, particularly during the harvest season and then you have religious workers. Religion is now tolerated, but particularly Santeria, and Santeria is a whole supply chain that provides, you know, the sacrificial animals and the other artifacts that go into Santeria.

So, adding all this together, you get another 600,000 to a million Cubans working in the private sector. Summing this altogether, 1.6 to 2 million Cubans, or up to 40 percent of the workforce, currently in the

private sector.

If you consider that the government plans to continue the expansion of the private sector over the next several years, by 2015 or so, it's quite possible to imagine up to 45 to 50 percent, half of the Cuban labor force, working in the private sector. That's a potent pillar for a hybrid, mixed economy, market socialism, if you will.

Who are some of these private sector folks? A lot of them work in these different forms of work that are all tolerated, officially sanctioned by the regime. Some examples: This fellow, Jesus, he's, has his own family-based construction company. He remodels homes, he's been doing it for many years. He's very articulate, very direct. He has a brother who does essentially the same thing in Los Angeles, California. I asked him, well, why didn't he migrate with his brother? He said, well, he prefers the Cuban lifestyle and would rather stay in Cuba. But he's prospering in his job.

Here we have someone fixing electronics equipment, cell phones, possibly the next Steve Jobs, who knows?

Here we have a woman who works in Havana Vieja. She has a great prime location where she sells artisan products made and designed by Cuban artists. She's very proud of that and she has ambitious business plans to expand her number of outlets and different

types of product offerings.

This fellow on the right owns a gym, a fitness center in Vedado, a residential sector of Havana, and so far, fortunately, the obesity plague has not yet come to Cuba and he's going to what he can to make sure that that remains the case.

A young painter with the owner of the gallery where she exhibits those paintings in the background, an example of the tremendous amount of artistic talent that makes money on the side privately and quite legally, in her case, in Cuba.

Owners of a restaurant, also in Cienfuegos, mother and daughter. A lot of restaurants in Cuba double as art galleries as you can see there.

And then here you have another, nostalgia is big in Cuba, and here's a nostalgic theme restaurant. Cuba was very proud of its trams and trolleys in the early part of the 20th Century, and this theme restaurant, which is quite spacious and modern, revives that nostalgic memory.

So, those are the types of people who are making a go of it in the private sector. We did, myself and my research assistant Colin Laverty, conducted in-depth interview or conversations or conversations with 25 entrepreneurs in Cuba plus many informal conversations with

many more Cubans working in Havana and Cienfuegos.

And based upon that, those conversations, we looked particularly at financing. Where does the money come from? Where does the money come from? And we found two basic findings. One is that the initial investments are actually rather large, larger than often imagined, and it is a wide variety of sources of capital that Cubans are able to tap into.

The average startup capital here, for example, entertainment, personal services, and retail, about \$7,000 per startup. For a bed and breakfast, up to \$36,000 for startup, so quite significant.

These are not the micro-enterprises that we think of in Latin American, a few hundred bucks for a woman to buy a sewing machine. These are substantial, small and medium sized businesses, SMEs, with the potential to really grow into dynamic private firms.

We also found that slightly more than half, 13 of these 25 firms, had benefited from capital injected from abroad by relatives and friends living overseas, and in one case actually, a silent investor from Latin America. But many firms also drew on domestic sources of capital including personal and family savings or from the sale of assets, such as a home or a car.

But not one of these 25 accessed commercial bank loans in

Cuba, not one. These entrepreneurs uniformly expressed either dislike or distrust of the national financial system in Cuba.

So the key finding out of this then, capital is scarce in Cuba, but not as negligible as sometimes believed and that capital suddenly appears, apparently out of nowhere, where opportunities for profitable investments can be found.

So there's a lot of dynamism, a lot of progress in the private sector, but certainly still, many obstacles and many frustrations.

And in our informal and in formal conversations, we catalogued some of these complaints, which are also found in some other studies. And what are these typical complaints that you hear from the people operating in the private sector?

One is no access to bank credit, two, scarcity of supplies. If you're in housing construction, hard to find the materials. If you're running a restaurant, hard to find some of the basic culinary ingredients. So, if you're in the cell phone business, cell phone repair business, very hard to find spare parts. So, scarcity of supplies, big problems.

Limited retail space. The government owns most buildings. Governments, in general, do not have the incentives to rent out that space. So it's hard to find retail space.

Still, many occupations, you're not allowed, 201, yes, the

rest, no. Particularly frustrating for many professionals who would like to form cooperatives or something on the side or privately, not yet permitted.

My report details various tax disincentives to growth. I won't go into the details here, but they're listed in the report. Still, petty harassment by government inspectors who are many and who find many reasons to demand bribes or sometimes even confiscate goods.

And then, possibly the biggest single problem really, is weak consumer demand, precisely because wages in the public sector, which is where most people still work, are so meager. So people simply don't have the liquidity to buy products.

And then there is an uncertain business climate because the Cuban regime, although it's making many changes, has not really indicated, really, where it wants to go in the end, what is the final vision? So hence, uncertain business climate.

So these are the common complaints, these are the issues that must be addressed if the private sector is going to fulfill its potential to be a dynamic center of capital accumulation, growth, exports, and revenue for the government.

Okay, my other topic, the middle classes. This is the second pillar for Cuba's future development strategy. There are a number of ways to measure middle class. Sometimes you measure it in terms of income

levels. That's very difficult in Cuba because of the exchange rate problems, because there aren't really very good numbers, so my report does offer some of those.

But let me suggest a different way to think about the middle class, which is contextually. The middle class is a contextual concept, and there are a number of ways we can think about that. By these measures, that I'm going to go through right now, Cuba measures up, as does much of Latin America, the more developed countries in Latin America, such as Mexico, Chile, Argentina, many Cubans could be considered as middle class.

Let me say, I delivered these remarks in Havana recently and the Cubans were like, what? What, we're middle class, wow. Because they never think in those terms, like workers and peasants. No, you guys are middle class. They said, yeah, wow, that's great, you know.

All right. First, educational attainment. There was a World Bank study that classified Latin Americans as middle class if they had 10.4 years of education. Your average Cuban has 10.2 years of education. That is to say, by the educational measurement, which is often what we most think of when we think of as middle class, human capital formation.

Most Cubans have the educational level of the middle class. Or, if we talk about female participation rights, women's rights in general,

women in Cuban participate in the labor markets roughly as middle class women do throughout Latin America. And if by modern and contemporary and middle class we mean access to family planning, contraception, Cuban women have very low fertility rates, the lowest, actually, in the Western Hemisphere.

Middle class is sometimes defined in terms of economic security, home ownership. Eighty percent of Cubans own their own homes, however dilapidated they may be, they still own them, and almost all Cubans have coverage by social security, even if the actual payments may not be large.

But by all of these measures then, the Cubans are a middle class society. Now the one area where they, where Cuba does not make it, of course, is in household consumption. You go into people's homes, they don't have all the goodies, all the stuff that we associate with middle class lifestyles. That, of course, they do not have.

But, they want to be there. They have those aspirations. And very often, you know, in the literature, middle class is defined in terms of aspirations. And if that's what you're looking at, definitely the Cubans that I've met have those middle class aspirations.

There is one other possible simple measurement of middle class social attainment, in my view. Can a citizen complete a lucid

sentence? In the United States, sadly, many high school graduates do not reach that level of articulateness, right? Sadly. Cubans, almost always, are articulate, can speak forthrightly, are socially competent, that is to say, are middle class, okay?

So, if we sum together, on the one hand, the emerging private sector, numbering as many as 2 million Cubans, 40 percent of the population and growing, and these middle classes, consisting by some characteristics of the majority of Cubans, already these two large groups, private sector middle classes, already define the new post-Castro Cuba.

The old narrative that Raul and Fidel Castro had to pass from the scene before real change could occur, that old narrative has already been discredited by current trends.

These rapidly expanding sectors of middle class and private sector, they hold the keys, together with the leadership of the still strong Cuban Communist Party, they hold the keys to the future of Cuba.

So, here we have, you guys want to know what the future of Cuba looks like? People are always saying, well, where is this going? Well, this is Feinberg's version of the future of Cuba. This is the version of the soft landing for Cuba around 2020, okay? We can all reconvene here in 2020 and see if Cuba looks something like this.

So, we have basically large-scale private business, together

with cooperatives, growing, open to diaspora capital and international lending because, right as things stand now, there's a limitation on their growth. Within Cuba, they cannot access modern technology, they don't have enough credits, they don't have access to international markets and trade and investment. That, they can only get that, if they are allowed to integrate more into the global economy.

But I also envision the state-owned enterprises, some of them at least reformed, as is being promised by the regime, which they are allowed, for example, to retain some of their profits and reinvest them as they see fit, operating a little more in a market economy situation, but in which the state-owned enterprises and the private sector interact with each other, buying and selling, both cooperating and competing with each other.

And then you have a Cuba more open as the government has continually hinted at, although it has not yet moved sufficiently in that direction, more open to foreign investment and joint ventures. Also interacting with the state-owned enterprises.

The Cuban government can promote, therefore, this active collaboration and strategic alliances between public sector and private sector to mutual benefit. Ultimately the whole system would be eventually fed by the international financial institutions, which was the topic of my

2011 monograph.

In this soft landing scenario, the Cuban economy becomes increasingly open to international trade and investment flows and re-integrates into regional and global markets. I would say that this hybrid system is stable in the medium term, even as the public and private sectors jockey for hegemony in the longer run.

In the Cuba case, it seems probable that the political attitudes of the emerging entrepreneurial middle classes will turn on the capacity of the government to respond flexibly to their interests.

If the government presents a closed exclusionary system, then unrest is predictable, even turmoil is possible. But an open willingness to share power and resources can create conditions for a soft landing in Cuba, a gradual shift towards a more open and prosperous future.

Here are the three options: The government basically clamps down, doesn't let the private sector grow, stagnation, frustration. Versus the inclusionary model, good relations, cooperative relations in public and private sector, a better business climate, and eventually a soft landing.

The soft landing scenario is not inevitable. It is not inevitable. I recognize that there's a lot of inertia built into a decades old

system of highly centralized state planning. There are still within Cuba today entrenched bureaucrats who subsist on rents and who have blocked innovation, there are multiple veto points and now, in the absence of Fidel Castro, uncertain approval authority. All of these are real potential brakes on forward movement and change.

But the inclusion scenario, the inclusion scenario, holds much greater promise. The emergence of a hybrid market socialism open to the international economy where a strong state sector both collaborates and competes with the growing private sector and the entire island is increasingly integrated into Caribbean based and global supply chains. So that's the model for the future.

We're at Brookings, we have to talk policy recommendations. So first, I'm going to have the temerity to make some recommendations for the Cuban government.

What can the Cuban government do to promote the soft landing? The Cuban government could articulate the clear mission laid out by the soft landing, that Cuba will pursue a hybrid market Socialism open to the international economy, and that this inclusive model of economic development will seek to advance legitimate interests, not only of workers and peasants, but of private entrepreneurs and the middle classes.

The Cuban government could also remove some of the many disincentives to business expansion that are enumerated in my report. And, very specifically, the Cuban government could allow access to training programs, including with international partners, whether it's governments, Brazil, Spain, Canada, and the United States, as well as to qualified non-governmental organizations. I think Carlos will address that issue in greater length. So those are some recommendations that the Cuban government could consider.

Now, here we are in Washington for the United States. Cuba will, of course, determine its own future. But external actors such as the United States, government and society, as we try to do on a worldwide basis, we can strengthen the forces for progress and we can reduce the cost of change and the dangers of political violence and regional instability.

That's what the U.S. could do, or the U.S. government can stand in the way of progress. It can deny Cuban entrepreneurs access to capital and markets, it can impede engagement of the international financial institutions.

Sudden regime collapse is the apparent goal of U.S. legislation, but I can tell you, from my own experience, and many friends in the executive branch, that the U.S. executive branch, for good reason,

fears this outcome of sudden collapse as entailing substantial risks for U.S. interests. Risks such as unpredictable violence, social disarray, opening space for international criminal syndicates, and possibly another massive exodus of refugees and strong pressures, therefore, for intervention.

Therefore, I suggest that the U.S. abandon this regime breakdown scenario as both unlikely and as dangerous. Rather, the U.S. should embrace the soft landing scenario as harboring the best chance for peaceful political liberalization.

While the internal dynamics of the hermetic Cuban regime are opaque, the uneven pace of reforms suggests ongoing struggles within the regime between orthodox Communists and economic reformers. U.S. policies that strengthen private business in Cuba bolster reform and increase the probabilities of a gradual, peaceful, economic transformation.

Therefore, the President should authorize U.S. firms to engage with independent entrepreneurs in Cuba. The U.S. should be allowed, U.S. firms, the President should authorize U.S. firms, to be able to provide material inputs and the credits that Cuban entrepreneurs so badly need to succeed. And U.S. importers should be allowed to broaden the consumer base for Cuban business.

And then, finally, the U.S. government should engage its

many, many time-tested tools to promote Cuban small and medium size enterprise. The U.S. has a whole gamut of programs to support SMEs on a worldwide basis. Within USAID, the Millennium Challenge Corporation, the Export Import Bank, OPEC, Small Business Administration, as well as multilateral, multilaterally through the MDBs, the World Banks' IFC, the IDB's MIF, all of these have instruments that are engaged on a worldwide basis, why not also in Cuba to support SMEs?

The U.S. should treat Cuba normally, as it would other authoritarian developing countries, and engage these programs.

So in conclusion, Cuba is undergoing profound changes, the U.S. has abundant, abundant opportunities to play a constructive role, particularly if it can coordinate with other regional and global players.

In a turbulent world, where events are often beyond the reach of Washington, right here in nearby Cuba, still relatively peaceful and stable, an historic opportunity beckons. Thank you very much.

MR. PICCONE: Thank you, give us one second to get miked up here.

MR. SALADRIGAS: Well, very interesting presentation by Richard. I think what he just described, in my opinion, is probably the most promising trend that harbors significant change in Cuba and that begins to provide the detailed outline of a kind of future that might bring

significant hope that Cuba can indeed change and that it can do so in peace with, and relative serenity for its own people and its own future.

The whole theme that he started, sort of, is based on the fact as to whether there can be a soft landing in Cuba.

And, of course, whether the Cuban leadership can indeed engineer a soft landing will depend on several factors.

One is whether reforms and changes can be timed in such a manner to avoid major social economic disruptions, but first and profound enough to really have an economic impact and avoid serious economic failures and collapse.

In other words, it is a delicate balance for the Cuban leadership to sort of balance the risks of change, the risks of changing, versus the risks inherent in not changing. And how that dilemma bears out, and how those decisions are taken by the Cuban leadership, I think is going to have a huge impact in ultimately what kind of outcome we're going to see as a result of these policies.

The second factor affecting whether there can be a soft landing will be the ability of the Venezuelan economy to continue to provide subsidized energy to Cuba. And this is a factor, again, that it's indeed happening, that we can all see the trains, we know what is happening, whether this becomes an additional impetus for more and

further changes in Cuba or whether it becomes a reason to slow down changes even further, that remains to be seen. I rather, I hope for the former and not the latter, but that clearly remains to be seen.

The third factor affecting the speed of change in Cuba and the ability to carry a soft landing is U.S. sanctions. Ironically, the sanctions regime that has been in place for many, many years, at least in part, was put in there with the objective of causing Cuba to change. And ironically, those very same sanctions are now having the very opposite effect. They are delaying and making it more difficult for Cuba to change. And I think the answer is very clear. You can look at the microeconomic reforms. These microeconomic reforms we're seeing here are important and can be learned, but when you look at the need for microeconomic reforms, you quickly come to the conclusion that it is very difficult for Cuba to enact and implement microeconomic reforms faced with the kind of sanctions regime that the United States has imposed on Cuba. So, that is clearly a point.

The fourth point, which is very important, is whether Cuba can develop the internal policies and the rest of the stuff, including the legal system, the jurisprudence, and all the things that are necessary to attract foreign investment, and to continue to attract diaspora capital. Which, of course, up to this point, and I think Richard certainly mentions

that in his paper, has been a major source, major, a very significant source. Probably, by some estimates, as much as 70 to 80 percent of the capital that has been fueling these small businesses has been coming from the diaspora, and it's our community. And whether that can be promoted and whether that can grow is going to depend a lot on how quickly and how easily a soft landing may be engineered.

However, essential to a soft landing is that there must be a landing. And what Cuba cannot afford to do is to continue to become a hovercraft that hovers above without moving, because eventually you run out of fuel and you crash. And I think this is perhaps an incredibly important message in the soft landing message. Soft land is clearly the kind of outcome that most reasonable observers and people invested into Cuba, as you would like to see, for a number of reasons, particularly for us Cubans where we know that we have a history, a political history, that's been a significant amount of bloodshed has been shed over the years to solve political conflicts.

So clearly, a soft landing is something that is very much wanted, and clearly the desire of the vast majority of the Cuban people living on the island. But there must be a landing. Things have got to change, and this is where, perhaps, one of the most important changes that needs to take place in Cuba is the mindset, and it needs to move from

bureaucratic to pragmatic. It needs to move from looking at the businessperson and entrepreneur not as a necessary evil, but as an important contributor to the welfare and the future society in Cuba.

And that mindset, it's happening, but it's fraught with problems. It has become incredibly clear to me and to many observers that one of the most significant problems that Cuba is experiencing today is what I call the Castro brothers' own Frankenstein and that's its very own bureaucracy. The bureaucracy that they erected and built is now turning against Cuba and the interest of Cuba. And as bureaucrats everywhere, it is creating a culture of rent sinkers, it is creating a culture of obstaculizing change, it is creating a culture that looks for their own economic well-being and future in Cuba, it is creating a host of opportunities for corruption, and it is delaying and holding back the significant amount of progress that these small enterprises and other future private enterprises can bring about in the future in the Cuban economy.

So I think it is important for the Cuban leaders to stop thinking in terms of reform. You cannot reform failures. There are things that have failed and they need to be changed.

So I think the mindset, to be effective, needs to change from one of reform to one of change. It is clear, and I'm not saying anything that Cuban leaders themselves, including President Raul Castro, has not

said. Cuba needs to change. It is not just enough to think of reforming. I think we need to start thinking of change.

The work that we have done at the Cuba Study Group focuses, perhaps, on that very important point, and it to create in the U.S. and in the Cuban diaspora, the political room to make a soft landing possible. And we think this is incredibly important and incredibly critical.

Our work has been geared, and I will tell you with significant success, has been geared to move the diaspora from a transitional obstacle to a transitional asset. And I think that is happening in incredibly significant ways, almost all of it below the radar screen. You will not see it published in Miami papers, you will not see it, hear it talked about, but it's happening en masse.

Last year, close to 400,000 Cuban Americans traveled back to Cuba. They are providing the capital for this host of, this incredible surge of small enterprises in Cuba. This capital is taking all kinds of forms, all of it informal. Some of it is straight gifts, outright gifts to relatives. It's easier to give them the fishing line for them to fish than it to have to give them a fish every week. You know, perhaps giving them \$20,000 is the easiest way to get rid of cousin Pedro, who has been nagging us for remittances for three years.

But it's much more than that. What's really happening are

people forming joint ventures, partnerships with their relatives in Cuba, and building up these businesses.

Informally, many of these businesses have even branched out. I know of one case where there is a lady that has five hair salons in Havana. Of course, you cannot have five hair salons in Havana, but they manage. That's the history of the Cuban people, they've really been able to manage.

So that change is already happening in a significant way in Miami. It just needs to seep up into the leadership classes in Miami and to the business community in Miami, but clearly, those changes are happening.

And in many ways, it's a game of cat and mouse. What we do here is going to have a huge impact in Cuba, and what they do in Cuba is going to have a huge impact here.

To the extent that is clearly seen that Cuba is moving in a definitive direction toward free enterprise, toward private enterprise, and that they indeed pass the necessary legislation and regulations to facilitate this process, that in itself is going to create more enthusiasm for people to become engaged in the process and to become participants in the process because, in the end, as Richard said very clearly, this, plus the growing middle class, plus the growing impact of civil society in Cuba,

those are the three pillars that are going to build the new Cuba.

Private enterprises, civil society, and the new middle class, which is not all that new in terms of the education and expectations. It's like one fellow told me in Cuba when I visited there a few years ago, he said, we are a first world people locked in a third world economy.

They think of themselves as middle class. They think of themselves as first world people, and they are, by virtue of their education, by education of their worldview, by virtue of their interests, their spirit, they are indeed that kind of person.

So fundamentally, it hinges on how this process unfolds and how much the Cuban leadership sees fit as China did. The biggest miracle in China's economy, economic model, is not, as many people think, infrastructure spending.

The biggest miracle in China's economic development is the unleashing of the individual to take economic risks and to seek economic gain through innovation and creation of enterprises, and so forth.

That is what needs to happen in Cuba. The individual needs to be free to, the creative potential of the individual needs to be free and unleashed to bring all those benefits to the Cuban economy while maintaining, as Richard pointed out, maintaining important social goals that the Cuban society may wish to have in the future.

Back in 2006, we issued a white paper in the Cuba Study Group called Unleashing Microeconomic Reforms in Cuba, Investing in Cubans. And we said at that point that Cuba's future, that we said Cuban leaders must face a fundamental reality. Cuba's future is unsustainable without domestic production and wealth creation. Continuing to ignore this reality will increase the inevitable transformational cost, make the transformation more difficult, and increase the probability of a breakdown in the social order, seriously leading to violence and perhaps rampant corruption.

In 2006, we called for these micro-enterprises, we called for enterprise formation, we called for small farms and agricultural cooperatives, we called for micro credits and credit of availability to the small business sector, and we called for loosening the immense capital that is locked up in Cuba real estate base. An enormous amount of capital is tied up in housing stock and in real estate in Cuba, and that needs to be unleashed in terms of a financial asset to fuel the economy.

In April, 2001, in cooperation with, in cooperation with the Council of the Americas, we held a summit in New York on small enterprise development and micro credits. And we also had Accion International as a partner with us in this particular venture. And we highlighted what were some of the major obstacles to Cuba's development

of small enterprises, and Richard outlined some of those.

I want to highlight two that he didn't mention too much. One is unpreparedness, or lack of preparedness, for competition, which is clearly important. And we are seeing that taking place right now, particularly in the *paradores* where they are facing new competition that they didn't have before. And the second one is learning how to run an effective business. If the people in Cuba do not know how to run a business, it's going to lead to unnecessary failures and, therefore, to a much higher cost of doing business and a much higher cost of capital. So having that kind of knowledge to operate a small business in an effective way, we believe, is critical to the success of these small enterprises in Cuba.

Last but not least, we believe that, we made a serious proposal at that point to the administration, which include many of the things that Richard talks about here. But we also said that we should allow small enterprises to export, private owned enterprises to export to the United States as well as to import from the United States and that we should allow U.S. firms to be able to hire Cuban individuals directly. For instance, if you're a firm developing software here, you could hire a programmer in Cuba and have that product be here and pay them for the process. Those are things that are going to significantly help, along with

the recommendations that Richard outlined in his paper, they will continue to promote the development of these small enterprises in Cuba, which is an incredibly important development.

And last but not least, to conclude here, these small enterprises are having a huge impact in fostering the reconciliation and the reunification of the nation. Because it is bringing about a way in which the society can interact horizontally as opposed to a society that used to interacting vertically between the state and the individual. It has allowed families to reconcile and help themselves and work together, even invest together, it has allowed communications among and between families, so it has had an enormous impact. Private economic activity has had an enormous impact in promoting the reconciliation and the reunification of the Cuban nation. And that brings me to a conclusion here. Thank you.

MR. PICCONE: Thank you, Carlos, thank you, Richard. A lot of information and thoughts and judgments and opinions on the table, and this is a very well informed crowd. So I want to get to your comments and questions. I just want to pose one, one or two issues that you didn't really address that I think need to be discussed. From my recent visits there and from talking to people, it's clear that there are two matters foremost in people's minds in the way the economy's behaving.

One has to do with human capital and decision by many

thousands and thousands and thousands of Cubans every year to leave. And the brain drain factor and how, what impact that's going to have on Cuba's future and its future economy, I think, is something that I think needs to be discussed and I'm wondering if you could share your thoughts on that.

Similarly, is the question of informality. As we use the term in other parts of Latin America, the black market, that there is a tremendous amount of economic activity that's happening on the streets, on the side, that's not being regulated, that's not being taxed. It seems a rather large lost opportunity on the part of the government. Most recently they've decided not to allow the re-trading of clothing and also they've decided not to allow people to show videos and DVDs in their homes. Could you give us your thoughts on that? Is that just a momentary step backward but the overall trend is forward, or does this tell us something that might say we're going in a different direction? Richard, and then Carlos.

MR. FEINBERG: Okay, yeah, thanks, Ted. On the question of brain drain, this is a problem not unique to Cuba at all. If you look at small countries, generally worldwide, certainly all the islands in the Caribbean, are suffering a lot of brain drain. Puerto Rico, half the Puerto Ricans live in the United States. My own son, you know, married a Puerto

Rican girl and she reports to me that virtually her entire high school class is living now on the mainland. So this is a general problem. I mean, if you were born in New Hampshire, chances are you would want to move to New York or Boston, right, I mean, where the action is. So this is, it's a tough problem.

But the Cuban leadership is very aware of this problem because many of their children and grandchildren have emigrated. And that's precisely one of the major stimuli behind the economic reform program, to try to reduce the brain drain.

Let me just mention the other thing. Historically, of course, Cuba was a recipient of populations, before the revolution. And I think, eventually, Cuba will return to being a recipient of populations, once they open up fully. And they're likely to continue to receive, for example, migration from the Dominican Republic and Haiti, as they had traditionally in order to provide sort of the less skilled work force that the island will probably need in the future.

On the question of the DVDs. So I think what you saw there is, as I suggested, an ongoing struggle within the regime between those who want to move forward and those who are nervous about losing control. And that ongoing struggle is precisely why, I think, it's important for the U.S. to engage, because the future is not given, and the U.S. and

international community should engage to strengthen the hands of the pro-reform factions within Cuba, as we would normally, of course, on a worldwide basis.

One thing that I think we've seen continually in the Cuban economy is that the Cuban leadership is not particularly concerned about Cubans as consumers. They think of Cubans as producers, maybe, as workers, they assure full employment, for example, but Cubans as consumer is not something, you know, that Marxist systems have paid a lot of attention to, right?

So, this is just one more example. Why should, we're concerned about controlling the production process, we're not so concerned about where the Cubans get to see what they would like to see in regard to DVDs.

We have another example of that with regard to the sale in Cuba of potentially very cheap, used, often used, clothing that comes from Miami or the passes through Panama. You see this throughout Latin America in which the goods are essentially sort of smuggled in the sense that they don't pay tariffs and it goes outside of the official distribution mechanisms.

In other countries, although people know this is going on, you see it in the malls all over Latin America, it's tolerated by governments

because they recognize this is a boon to poor consumers who can afford cheap clothing that they couldn't afford otherwise. But in Cuba, where the consumers are not given a lot of weight, they're more concerned about controlling the distribution process and so, hence, a step backwards.

I thought it was interesting, they initially announced, you can't do this anymore, over the summer. That's a direct attack on thousands of mostly women who are engaged in this process of distributing clothing. And there was a howl that you could hear throughout the island and the government took note and stepped back, and the government then said, okay, we're not going to enforce this immediately, you have until now January to at least sell off your inventories, and then, you know, we'll see where we go from here. So I thought it was an interesting, you know, sort of recognition, oops, we went too far, there is public pressure that we have to respond to, so we're going to step back and allow this process to continue for at least the next six months.

MR. SALADRIGAS: On the issue of brain drain, it's clearly a very significant issue. The latest statistics that I saw indicate that the population shrinking faster than ever as a result of the new migration law that's making it easier for Cubans to leave. The good thing about this law is that it also allows them to come back, where before, if, you know, you left permanently, which means that it was very difficult for you to return.

So, in the changes that are taking place in Cuba occur fast enough and open enough, I think there's no doubt in my mind that we will attract a lot of that human capital that has left to come back to Cuba. But it all depends on how fast those changes are made, because over time, people settle down, and once they do settle down, it will be very difficult to get them to return. So that's one aspect of the thing that I think is important.

On the second one, I take a little more pessimistic view because in my different trips to Cuba, I've spoken to a lot of entrepreneurs and small business people, and there is this dark cloud hanging over all of them as to the uncertainty of the future. This is a government that has a track record of moving forward and then pulling everything back. And they've done it not once, not twice, but several times, and I think you outlined those instances in your report.

So, every one of these things, like now banning the home theaters that are popping up all over the place, like banning the distribution of DVDs, like banning the sale of used clothing, most of which comes from the diaspora, and from other places outside of Cuba, those things, while individually might not be that significant, collectively they have a dampening effect on the spirits and the hopes and the aspirations of these people and these small entrepreneurs in Cuba. So, that, in my

opinion, was a big negative. It fuels the fears that there's going to be another crackdown of these activities, that we're going to take five steps forward and three back, or four back. So rather than giving people more certainty, which is what you want to do to encourage investment and to promote additional investment, this just increases the level of uncertainty as to what is the intention of the Cuban leaders and where is all of this going.

While individually, these actions are not that critical, the message that is being sent, in my opinion, is highly negative.

Just last week, the Gaceto Oficial issued this document: 13 pages of regulations on how to lease public toilets. Thirteen pages of regulations! This tells you what's wrong with that system, and why, unless this changes, it's going to be very difficult to see some real progress. It's just too obtuse.

You cannot have a country that's run by bureaucrats and have it be effective. You need to have leadership in the way of direction. And this is a clear example of how to make it difficult for people to do business and to grow the economy of the country and to create wealth and to create domestic production and economic activity. I mean, the biggest difficulty the business, all these businesses have in Cuba is a very thin domestic consumption market. And unless measures are taken to

increase wealth and increase productivity to increase the size of the domestic market, it's just going to become very difficult for these enterprises to prosper.

MR. PICCONE: It does promote, suggest a question, who is benefiting from the current system, and to what extent the state owned enterprises and the bureaucrats, perhaps, really have a vested interest in the status quo in our, laying out these kind of roadblocks and 30 pages of regulations on public toilets. I think you mention that in the report, and I think that's going to continue to be a real tension as the reforms go forward.

We have some time for comments and questions. I have a lot of hands, so we'll take two or three at a time, if you could identify yourself and keep it short. We'll start in the back, the gentleman in the aisle there, yes.

MR. HUERTO: Yes, thank you very much. My name is Emilio Huerto and I am a concerned Cuban. And I have a comment for Professor Feinberg. I read with great interest your recommendations to the Cuban government and I would like to add one. I'd like to add the allowance of political parties, opposition, and greater respect for human freedom. Otherwise we will have a soft landing in the wrong place. Thank you.

MR. PICCONE: Thank you very much. The woman here in the middle?

MS. KELLY: Hi, I'm Sonja Kelly for the Center for Financial Inclusion at Accion and I'm also a Ph.D. Candidate at American University. I'm interested in this access to capital issue in the soft landing scenario, and I wonder if the soft landing scenario depends on private capital and material investment or if there's a possibility of Banco Popular developing kind the trust it needs and also the capacity to be able to offer capital to people for enterprise development. Thanks.

MR. PICCONE: And let's take one more. Alec, did you have your hand up?

MR. WATSON: Hi, I'm Alec Watson from Hills & Company, and Carlos and Richard, that was a really fascinating presentation. I wonder if you could touch a little bit on the role of the military here, because you read that a lot of the military, either active duty or former active duty, have extended themselves deeply into the economy of the country and control lots of enterprises. And I could imagine you could have a dramatic reaction by the military that, on the one hand it controls the repressive power of the state, and the second, on the other hand, has a very strong interest in the maintenance of at least certain aspects of the status quo, and how you could see the role of the military evolving in the

future if the underlying changes that you're talking about take place.

MR. PICCONE: Okay, great questions. Why don't we come back to the panel and then we'll come back to the audience. Who wants to start first? Human rights, Banco Popular, and military.

MR. SALADRIGAS: Well, on human rights I think, as humans, we all feel the same way as Mr. Huerto expressed. It is important. It's not a matter to be dismissed or to be ignored but, and it is, it has to be addressed. But, you know, I personally believe that economic development leads to civil society formation and civil society strengthening and that in itself creates the biggest source of internal pressure for political reforms and for the defense of human rights.

So, it is clearly an issue that needs to be at the forefront, and it is at the forefront, but it needs to be looked at in the context of all the important issues that come together as we dream and think of a different future for our country.

I think Richard hit it right on the point. It's inclusion, it's inclusiveness. I think we all long for a future in Cuba that is much more inclusive. We have had enough exclusions over the years on both sides of the Florida Straits to deal with, and we know what the results of that exclusion have been over 50 something years, again, on both sides. So, I think we are all anxious for greater inclusion and greater participation in

shaping the future of our nation. So, that, I think, is very important.

On the military, the concern that I think a lot of people share is, how is, because when we talk about a soft landing, first of all, I'm going to show what the definition is. We all have our own image of what it may be. But there are, there's not a, it's not an either or. It's not an either a soft landing or a hard crash. It's a multitude of possible outcomes in areas that we may have. And one of, one of those scenarios which, I think, could be rather detrimental to the future of Cuba, is a more oligarchic economic opening. And the question of what role the military might play there, I just don't know. But we know that there is, that there is, every single narco business in Central America, every single narco criminal group in Central America have their eyes cast on Cuba. And they're hoping for the slightest breakdown in law and order to set up shop in Havana.

So, all of these factors need to be looked at in conjunction and this is why an orderly process, if that's one definition of a soft landing, could be so important for the future of Cuba, because there are just too many ramifications in which this can go.

MR. FEINBERG: Okay, yeah, great questions, thanks. So Alec, so I certainly don't and I don't know other people who have access to the senior military leadership, so I can't really say I have any first-hand

information. What you generally hear, though, is that because the military are technocratic and they recognize the dramatic inefficiencies in the current system, that they tend to be pro-reform. That's what I hear from, you know, third parties.

In my model, you have to give the current military leadership a stake in the future, right, practically. Therefore, idea that, yes, they have a stake because in the reform state-owned enterprises, where they are very present, that will have, that has a future in a soft landing model.

And so they will, so military leaders gradually become technocrats who gradually become equity shareholders in reform state-owned enterprises and that gives them, therefore, a stake, in not only not opposing, but actually participating in the soft landing scenario. I hope that's something you consider to be reasonable, Alec, yeah? Are we on the same wavelength here?

MR. WATSON: You're always reasonable.

MR. FEINBERG: Thank you, Alec, okay. On the question of access to credits. So there are three state-owned banks now that are allowed to lend to the small-scale enterprise in Cuba. But they haven't done, they've done very, very little, as I pointed out, partly because of institutional inertia. They don't know how to deal with small-scale risk-taking businesses, and also for lack of liquidity. They just don't have a lot

of money. That's why I basically suggested that, really, capital has to come from other sources, that is to say, international diaspora, or et cetera, or family businesses, whatever.

I can imagine, and that's why I think it's important for NGOs like Accion to be allowed access and to be allowed to ply their trade, which they've done so successfully all around the world. I could possibly imagine the state-owned in banks in Cuba establishing sort of specialized subsidiaries where you had loan officers who were well-trained and did understand how to interact with the private sector. That might be a way forward.

MR. SALADRIGAS: I just wanted to mention that I take a very dim view of what is perhaps the prevailing thinking that the Cuban military are efficient and that they can run business efficiently. You know, it's very easy to be efficient when you run a monopoly. It's another thing when you're facing competition. The only thing that makes you truly effective, efficient is competition. And, of course, they are not used to running businesses in a competitive sense, in a competitive setting. So, it remains to be seen how effective those military-run enterprises may be if they indeed open up to competitive forces on a worldwide basis.

MR. PICCONE: Okay, let's come back to the front. I have a question here in the front?

QUESTIONER: Thank you, my name is Sonia Short. I am with (inaudible) Americas. I was wondering if you can make some comments on how do you see or how should be Latin American countries' position. It's not just only Venezuela supporting Cuba. It's also the peace process, the Colombian peace process, taking place under the Castro umbrella. And it's a fact that every elected Latin American president pays a visit to Cuba. So, I would like to, to hear your comments on that. Thank you.

MR. FEINBERG: Well, to answer that, Cuba is hosting a summit in January of all Latin American and Caribbean heads of state. Thank you very much.

MS. FAGEN: Patricia Fagen, Georgetown University. I have one basic question with some component parts. And the underlying question is, how would you incorporate rural Cuba into the dynamics you're describing and into the model that you've put forward. You've mentioned, Richard mentioned, that there are Cuban farmers that now own their land, which is really important. By the way, this a terrific presentation. I should have started off by saying that. It's encouraging and it's exciting.

But are these farms that are near cities, are these farms that are out further, are they small holdings, are they large holdings? Is, are

there the restrictions still in place that prevent people from moving to cities? Is Cuba likely to go the way of the rest of Latin America that becomes incredibly urbanized? Seventy-five percent of Latin America is now urban than rural, so I'd just like you to comment on the rural sector and how it fits into these linkages, backwards and forwards linkages that you've described in terms of enterprises and --

MR. PICCONE: Thank you, and Mark?

MR. SULLIVAN: Mark Sullivan, Library of Congress. My question kind of dovetails with Patricia's question, about to what extent, Richard, is your research efforts focused on Havana, and your look at the reforms, and to what extent is this replicated in other cities across the country? Particularly when you have the characterization of Cuba's being middle class, I'm sure there's got to be big differences between Havana and other cities.

MR. PICCONE: Okay, thanks. Want to come back to you all?

MR. FEINBERG: Sure. Yeah, another great round of questions. In terms of Latin America, of course the United States has very long been isolated from most of Latin American opinion, both official and public, with regard to Cuba policy.

When President Obama was at the Summit of the Americas

in Cartagena two years ago, he received a tongue-lashing from all the Latin Americans on the Cuba issue. And, you know, he was so dramatically isolated, not only by the ALBA countries, you know, but by his host, Santos from Colombia, et cetera.

So, I think what the U.S. should do is work with countries such as Brazil, Chile, Mexico, who are interested in engaging in Cuba to promote the very types of programs that we've been talking about here. And the extent to which we can work with them, of course, increases everyone's leverage mutually and it's burden sharing and cost sharing, et cetera. So, I think that's what I think we should do.

I think, very specifically, the Brazilians and others have said that Cuba ought to be a member of the international financial institutions. And I would suggest, as I did in my paper on the IFIs in my 2011 monograph, that the Latin Americans should form a friends of Cuba group, in which they work within the IFIs to gradually bring Cuba in. Of course, Cuba has to show that it's willing to do that, to be a member gradually, but I think it would be in everyone's interest for that to occur.

With regard to, well Mark, I want to reassure you that not only, I did get outside of Havana, the report has a number examples from Cienfuegos, a number of those pictures were from Cienfuegos, including the cover picture. That's a restaurant in Cienfuegos. And more recently I

spent a week in the Oriente, in Santiago, Holguin, et cetera. And you can feel the reform processes there as well.

In my report there's a little vignette of a cooperative, a new construction cooperative, based in Santiago de Cuba. Now I think what has happened historically, now initially, the revolution comes in, and rah, rah, peasants, and there was a real effort to extend basically the social services into the rural areas. And so there was an uplifting.

But over time, you had basically a repression of agriculture, largely because of the price system, you know, just completely repressed agriculture. So you have this very sad situation of, in product after product, where Cuba was even an exporter before the revolution. Now they're importers and production is a fraction of what it was before the revolution. We're talking about coffee, even sugar, citrus, fisheries, I mean, all this has been decimated, unfortunately, and a lot of it has to do with pricing mechanisms.

So, the government is beginning to address those issues, but just beginning, because, of course, if you raise, in the short-term, when you raise agricultural prices, it gives stimulus to agricultural production. But in the very short run, you know, urban consumers will complain. So that's, you know, it's a political call.

Just recently, though, they announced the opening of

wholesale markets for agricultural products in which the buying or selling would be entirely done by the private sector all up and down the supply chain, and that's an important step forward, you know, in that direction.

Eventually, a lot of the need for investment and productivity enhancing technology, et cetera, has to come from international engagement. And that is something that the government of Cuba has not yet been willing to open up to.

The Brazilians, you know, have been knocking at the door now for years, saying, let us in to the sugar sector, in particular, and let us to biomass, ethanol production, et cetera. We're so efficient, we're the world's best, we can do it for you. Even with the Brazilians, the Cubans have been very hesitant to allow them into the agricultural sector. I think that needs to change.

MR. SALADRIGAS: You know, the economic history of Cuba is littered with economic disaster after economic disaster. And I think there's another one in the making, and that's to try to promote the resurgence of the agricultural sector in Cuba through small family-owned farms. It's just not happening. Fundamental, you saw the numbers here that Richard presented with a population that has 10 and a half or 10.7 years of education. You know, like a, some fellow in Cuba told me, says, I have a doctorate degree, I don't want to go back to the farm and plant

potatoes. I want to do, I aspired to something better.

There is also another factor. At the time the revolution came, about 65 percent or higher of the Cuban population was rural. The rest was urban. That number is now reversed. Now the number of people in urban living is close to 80 percent. So, it's a very different scenario than Vietnam. So, for those that look to the Vietnamese model as perhaps a solution in Cuba, I don't think that model is going to work at all. I think Cuba's agricultural resources and wealth can best be created by larger, more mechanized farms and cooperatives. So, that all remains to be seen how that sorts out.

MR. PICCONE: There's another element to the urbanization issue, which is housing. Housing has proven to be a real challenge for the government, and there's, you see a lot of doubling up of very crowded and dilapidated housing that needs massive investment from, probably externally. We have time for just a couple of more questions, I see Peter in the way back, and then this gentleman there.

QUESTIONER: Hi. Let me, Richard, let me say you did a lot of creative estimation, which I think is very valuable in terms of the number in the private sector, the number in the middle class, and this is a point where I think you and Carlos disagree a bit, is what if you went back to when the reform process started? I don't know exactly when you

consider that start to be. What were the numbers that your creative estimation would be in each case? It seemed to me, as Carlos suggested, that Cuba was basically middle class before these reforms started. It was, there was lots of private sector, it was called, all of it was black market then, or a lot of people in government were, in other words, how much, what is the pace of the reform? Does that come out at all and can you give some sense? Are there now 20 percent more in the middle class, 30 percent, are there more, 20 percent more in the private sector? In other words, what is the pace?

MR. PICCONE: Okay, this gentleman to the right? Yes.

QUESTIONER: Pedro (inaudible). Richard, just along, exactly on what Peter highlighted. Anyone who's been to Cuba, I think, would realize, under your definition, let's say middle class, anyone who has an aspiration to be middle class, one could say that everybody's an entrepreneur. Every single person is an entrepreneur. I mean, the fundamental element of Cuba survival is entrepreneurship.

(Speaking in Spanish).

One thing, that I think it's important, is to focus on the ethical elements and the legal elements associated with that. A lot of what is being done is basically undermining ethical values in society and, in many cases, violate laws.

Some laws are capricious, but sometimes it's really, truly not law-abiding activity. The fundamental issue for people like us who have been working a great deal with the Catholic Church, is how do you set and imagine a country that does not have the institutions of the free market, definitely does not have the institutions of democracy, but does not have the value systems that actually can sustain and avoid the outcome that Carlos mentioned, which is that you end up morphing from Marxism, or fidelissimo, into crony capitalism. And that's a real risk. And that crony capitalism, which usually has very weak institutions, will be captured by rate seekers of all sorts.

The thing that happened with *paradores* in '95 and after, there are 3,000 *paradores* in Havana, I mean this is not a new phenomenon. A few years ago, there were 39 left. What destroyed them was rate seekers, was the tax guys, was the inspectors, was the neighbors, was everybody tried to make money from the guy who's been successful. And I'll just say that whenever you analyze (inaudible) was doing, the fundamental change is that entrepreneurship cannot be a tool of the government uses for people to substitute their meager income, which is what they think. Anybody who makes more money than the government wants gets stopped. I think anybody who's successful right now, like Carlos says, has this massive cloud because it is not a

fundamental change. The government cannot pay meager \$19 and \$20 salaries and a few people have alternatives, but they don't want them to make \$19,000 or \$190,000 or \$1.9 million dollars. They still have not made that switch and I'm not sure that they're ready to do it. And that's a change in (inaudible) and it's nothing to do with U.S. policy.

MR. PICCONE: Thank you. Those are really thoughtful comments. Before and after, I think, is the real question here and after, I suppose, the (speaking in Spanish). Final comments.

MR. FEINBERG: Well, thank you very much, Peter. I'm not claiming that the middle classes that I discuss here is the result of Raul Castro, quite the opposite. I think what happened, at the time of the revolution, much of the upper middle classes, of course, migrated. The society was decapitated, so to speak. That allowed for dramatic social mobility, right? We've seen this in other Latin American countries where a lot of the upper classes, like we've seen this in El Salvador and Nicaragua, where a lot of the upper classes fled because of political turmoil. That allows for the creation of a new middle class. And so we thought we've seen that over a period of time.

That middle class is the product, the legitimate outcome, of the revolution. It should not be seen as attacking the revolution or as something that's contrary. It's something that rather the revolution can be

proud of and, therefore, not see as antagonistic. And that's a very important point, I think.

With regard to, yes, a lot of the activity that has been legalized was, did exist informally, as Phil Peters's work, for example, now has pointed out. But, still, if you travel around Cuba, you see a lot of entrepreneurial activity that did not exist five years ago, whether you're talking about fancy *paradores* that did not exist, everybody selling *capateria*, the remodeling of homes that's going on increasingly. That exists in a much more dramatic way than existed before.

In my paper I also have a number of case studies that you can look at. Those types of activity did not exist before.

Would we like to see reforms that are more rapid? Most of my friends in Cuba, yes, they would like to see a more rapid pace of reforms. But I do think that it's important to see that there is, I think there's an acceleration. Yeah, there were two steps backward with the DVDs and the selling of used clothing, but five important steps forward just in the last, the opening up to agricultural wholesale markets, really a dramatic and important change, possibly. The expansion of the number of allowable occupations from 181 to 201, and then a number of other things. So, I would maintain that we're still seeing quite a bit of forward momentum.

MR. SALADRIGAS: I think, fundamentally, there is a myth

that is sometimes --

MR. FEINBERG: I'm sorry, excuse me. The issue of taxation was raised by Pedro Urele. The government is gradually moving from, you know, a system of internal transfers, of material accounting, you know, the old Socialist system, to a system of taxation, which would be more legal, more transparent. This is, you know, something that is not easy to do. You know, we here in the United States are endlessly talking about simplifying our taxes, tax reform, et cetera. The private sector always complains that taxes are too heavy, right? I mean, that just goes with the territory.

What I think has been interesting is that they have been trying, they've been responding to complaints about the tax system. And, whereas in the past, they tended, when they did previous reform efforts, like in the '90s, and Fidel decided he wanted to pull back, he increased the taxes, made it more burdensome. What you're seeing here is the opposite, that the tax changes, and they're implementing them continually, by the way. These tax changes have been in response to complaints from the private sector to try to make things a little more rational, a little more transparent.

Do they have a long, long way to go? Should they be working with the World Bank and the IMF to have a much more efficient

and effective tax system in every respect, that is to say, more transparent, more rational, more efficient, a much better tax collection system? They don't, it's not digitalized. They don't have computers in their treasury department equivalent. They're still using, you know, scraps of paper. I mean, so they've got a long way to go before they have an efficient tax system. But they've announced their intention to do that and they are taking initial steps in that direction.

MR. SALADRIGAS: Well, I don't know, I think, in summary, I think that there's a myth that some people like to perpetrate, that Cuba has not changed, that everything's the same. It's the same, the same thing, perhaps dressed a little different. That is not true. I think Cuba has undergone significant change. A lot of the changes, they're clearly not as profound or thorough as we would like them so see, but they're nonetheless very significant changes.

Perhaps the most important change in Cuba is not anything that the government has reformed. The most important change in Cuba is that the Cuban people are changing. And all, anyone that travels to Havana and spends a day, or Santiago or anywhere else, will see that, and that alone is an incredibly important and significant change.

The story of the small enterprises is real. This is bringing about enthusiasm, growth, better living standards for some people, but it's

also a very sporadic picture.

Most of the economic activity that Richard alluded to is happening around the tourist centers: Havana, Matanzas, Oriente, Holguin, a little bit in Pinar del Rio, Trinidad, so forth. But there are towns in Cuba that have, don't see anything like this, they have not seen any kind of change, any kind of economic development yet. So, it's very sporadic.

It's also racial, because a lot the capital that has come from, that has come into Cuba from the Miami diaspora. The Miami diaspora is 98 percent white. Okay, so the Afro Cubans are perhaps suffering the brunt of the economic, are not benefiting from the economic development that is happening across the island.

So there are a lot of problems here. Does that mean that these changes are not good? Of course they are and we need to hope and to expect that there will be more. But it's going to be a difficult process. And I think, Pedro, you hit it right on the nail, and this is the significant worry of the church, is the values in this population. There's still a penchant for promoting informality.

The 13 pages of regulations on toilets is just an opportunity to create informality, create corruption, and informal markets. Black markets are the quintessential free markets, but they're not ethical

markets. And I think it's the lack of an ethical construct that arises out of informal economic activity that I think we need to deal with.

And this is not your worry, or my worry, or the church's worry, it's also Raul Castro's worry. He said it not too long ago. So, this is clearly something we need to be concerned about, and the quicker and more profound and more transparency and more clarity that the government gives to all these changes, the better it will be for Cuba's own future, and for a softer landing, and a landing in the right place and the right direction. I think that's what we're hoping for.

MR. PICCONE: I think this morning's discussion gives you a sense of just how complex the situation is, that there are some important changes underway. We think that it's worth studying in depth and putting great minds at work to understanding, and of course, it's not a very transparent system, so that's also one of the challenges in getting your arm around the statistics.

You'll actually get to hear from some of these entrepreneurs at a program that the Center for the Study, nope, Center for Democracy in the Americas is organizing next week on the 13th, so I'm sure you're welcome to attend that. And thank you, and thank my panel for joining us.

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