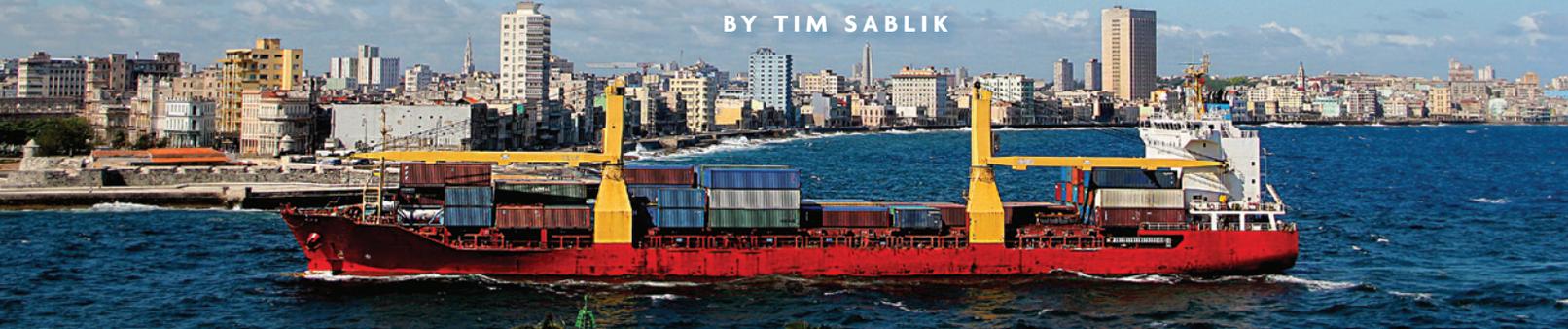


TRADING WITH CUBA

As U.S.-Cuban relations begin to thaw, agricultural exports from Southern states may provide a hint of what future trade will look like

BY TIM SABLIK



It's about a three-day trip by sea from Norfolk to Havana. In spite of the long-standing ban on trade and travel between the United States and Cuba, cargo ships have made that journey numerous times over the last 12 years. In 2015, Virginia exported \$41.6 million in agricultural goods to Cuba, just over a quarter of the U.S. total.

"The types of agricultural products that the United States exports to Cuba are very similar to the ones that it exports in general," says Steven Zahniser, an economist with the U.S. Department of Agriculture (USDA). For Virginia, that has included, among others, soybeans, chickens, and apples.

Such exports are made possible by the Trade Sanctions Reform and Export Enhancement Act of 2000, which exempted certain foods, medicines, and medical equipment from the Cuba embargo. Virginia was an early participant in the new avenue for trade and, along with other Southern states like Louisiana, Alabama, Georgia, and Florida, has consistently been one of the top U.S. exporters to Cuba (see chart). In 2003, then-Gov. Mark Warner sent the first Virginia trade delegation to Cuba, and subsequent governors have continued to build on that relationship. Todd Haymore,

currently Virginia's secretary of agriculture and forestry, has led those efforts since 2007.

Haymore says he has long hoped that cultivating relationships between Virginia and Cuba will put the state "at the front of the line" for new opportunities in the event that the embargo is lifted. "As we started to talk more with American and Cuban officials, we sensed that it was not a matter of 'if' but 'when' things were going to change," he says.

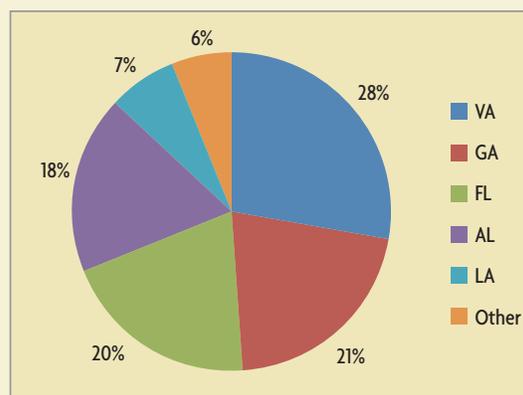
"When" may be sooner rather than later. In December 2014, President Barack Obama announced a number of changes to U.S.-Cuba relations, including easing sanctions and travel restrictions. In the summer of 2015, the two nations resumed diplomatic ties and the United States reopened its embassy in Havana. As a result, many additional businesses are now eagerly eyeing expansion into the Cuban market. But for latecomers, how challenging will it be to open economic doors that have been shut for 55 years?

A Sweet Start

Before the embargo, the United States and Cuba had a long history as trade partners. In the mid-19th century, Cuba dominated the world sugar market, producing an estimated one-quarter of the world's sugar. The United States, less than 100 miles away and with a comparatively much smaller sugar-producing sector, was a natural importer. The ties between the two countries strengthened in 1884 when world sugar prices plummeted, forcing a number of Cuban mills into bankruptcy. American firms invested heavily in revitalizing and modernizing the sector. In fact, these economic ties may have played a role in America's decision in 1898 to support Cuba's war of independence against Spain.

After the war, the United States and Cuba continued to trade heavily. Between 1902 and 1920, Cuban sugar exports more than tripled, with nearly all of that volume destined for the United States. During this same period, the United States continued to invest in the Cuban agricultural sector. According to a 1999 article by Alan Dye of Barnard College and Richard Scotte of the University of Vermont,

Shares of U.S. Agricultural Exports to Cuba in 2015



SOURCE: U.S. Census Bureau trade data, U.S. state export data

the United States invested more than \$5 billion in Cuban agriculture between 1896 and 1957 (\$67 billion in today's dollars). By the mid-1920s, U.S. firms owned more than 60 percent of Cuba's sugar production. Cuba, in turn, was a major importer of U.S. agricultural products, particularly long-grain rice.

But that outward cooperation masked underlying tension. As a precondition for removing its troops following the Spanish-American War, the United States insisted that Cuba relinquish its authority to approve foreign treaties. Cuba was also required to lease land to the United States for naval bases, including the one still at Guantanamo Bay. While some of these provisions were eventually repealed in the 1930s, they angered many Cubans who had fought for independence.

During the Great Depression, the United States introduced new tariffs and quotas, including on sugar. This contributed to a collapse of the Cuban sugar industry, which was still heavily reliant on exports to the United States. Dye and Sicotte cite this breakdown as a key motivating factor of the Cuban revolution of 1959, which, among other things, sought to reduce Cuba's economic dependence on the United States.

When Fidel Castro's regime came to power, he nationalized private property and assets belonging to American individuals and companies. In response, President Dwight D. Eisenhower imposed a partial embargo in 1960 and cut diplomatic ties in January 1961. Following the Bay of Pigs Invasion in 1961 and the Cuban Missile Crisis in 1962, President John F. Kennedy strengthened the embargo to include all goods and instituted a ban on travel and financial transactions between the two countries. While President Jimmy Carter allowed travel restrictions to lapse, they were reinstated under President Ronald Reagan, and the embargo as a whole remained largely unchanged throughout the 20th century.

Trade as a Weapon

Sanctions or embargoes have a long history of being used either to punish enemy states or to apply pressure on the leaders of those states through nonmilitary means, with varying degrees of success. (See "Under Pressure," *Econ Focus*, First Quarter 2013.) In the United States, sanctions became a popular policy tool in the aftermath of World War I, coinciding with America's rising economic importance. The Trading with the Enemy Act of 1917 gave the president the authority to impose trade and financial restrictions and seize property of countries deemed hostile to the United States. Cuba is the last remaining country still subject to that act — North Korea was removed in 2008.

The initial trade restrictions against Cuba in 1960 were designed to retaliate against the Castro government's seizure of U.S. property and assets and to discourage its close ties with the Soviet Union. But to many, the Cuban embargo has served as an illustration of why trade sanctions are often ineffective: It is very difficult to completely cut a country off from world trade without widespread support. For example, while many other countries in the Americas initially joined

Exports to Cuba (\$Millions)

Country	2000	2005	2010	2014
Venezuela	1010.9	1901.68	3444.65	3491.58
China	257.26	698.87	1173.02	1169.45
Spain	613.84	660.28	850.55	994.25
Brazil	104.03	270.05	456.36	558.56
Canada	228.84	407.93	417.09	445.62
Mexico	230.13	243.75	338	398.52
Italy	275.08	269.53	268.63	329.59
United States	3.41	397.87	407.55	328.97
Argentina	58.32	106.52	97.15	300.02
Germany	70.92	348.73	226.04	261.33

SOURCE: International Monetary Fund, *Direction of Trade Statistics*

the United States in sanctions against Cuba, they lifted those restrictions in 1975.

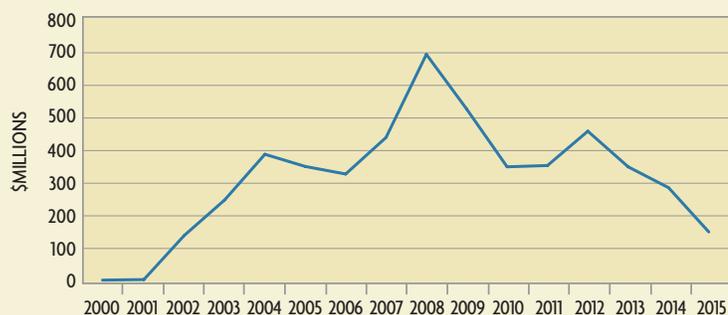
More importantly, from the 1960s through the 1980s, Cuba traded heavily with the Soviet Union. According to a 2002 article by William LeoGrande of American University and Julie Thomas (now Julie Mazzei) of Kent State University, as much as 70 percent of Cuba's trade was with the Soviet Union in the 1970s and 1980s. Between 1960 and 1990, the Soviet Union financed Cuba's trade deficit by providing more than \$17 billion in credit, as well as billions of dollars per year in other economic assistance, according to LeoGrande and Mazzei. This helped to shield Cuba from the effects of the American embargo until the dissolution of the Soviet Union in the early 1990s.

When the Soviet Union collapsed in the early 1990s, Cuba's economy entered a severe downturn. The United States responded by strengthening the embargo with the goal of pressuring the Castro government to engage in democratic reforms and improve human rights. As outlined by the U.S. State Department, abuses by the Cuban government include maintaining single-party rule through force, restricting free speech through arrests and intimidation, and denying fair trial and religious expression, among other things. The Helms-Burton Act of 1996 also attempted to pressure other nations to refrain from trade with Cuba by threatening legal action against firms or individuals who engaged in transactions involving property (physical or intellectual) that was confiscated from U.S. firms or individuals by the Castro government. The United States has also blocked individuals from entering the country for the same reason.

Still, it is not clear how effective these measures have been at actually preventing other countries from trading with Cuba. According to a 2014 book by Gary Clyde Hufbauer and Barbara Kotschwar of the Peterson Institute for International Economics, Cuban trade with countries like China, Venezuela, Canada, and some European countries grew considerably over the last two decades (see table).

The United States itself has also not been fully committed to blocking Cuban trade, as evidenced by its agricultural

U.S. Agricultural Exports to Cuba



SOURCE: U.S. Census Bureau trade data

exports. Despite a number of financial restrictions, such as the requirement that buyers in Cuba must pay with “cash in advance” and route all transactions through a third-party institution in Europe or elsewhere, U.S. agricultural exports have at times been fairly substantial. According to the USDA, Cuba imported nearly \$700 million in goods in 2008 (see chart). From 2012-2014, the United States was Cuba’s second-leading supplier of agricultural imports (behind the European Union). And even before such exports were allowed in 2000, a U.S. International Trade Commission report found that the embargo had minimal impact on most sectors due to the availability of substitute trade partners for both the United States and Cuba.

Still, proponents of the embargo say that it is a powerful bargaining chip for pressuring the Cuban government to engage in political and humanitarian reform. On the other hand, critics have argued that the embargo has in fact done more harm than good when it comes to furthering those goals. A 2009 Amnesty International report called for lifting the embargo, citing evidence of its negative impact on “the economic and social rights of the Cuban population, affecting in particular the most vulnerable sectors of society.” And a number of economists and political scientists have long argued that, rather than encouraging political reform, sanctions can actually empower oppressive regimes by providing a convenient scapegoat.

“The problem is that when you have a big country like the United States punishing a small, poor country like Cuba, it’s very easy to portray that as not very nice,” says Ricardo Torres, an economist at the University of Havana. “It generates a lot of sympathy for Cuba. And that in itself distracts people from what should be the real focus, which is the working of our economic policies.”

It Takes Two to Trade

Even if the United States ended the embargo with Cuba tomorrow, it’s not clear how willing or able Cuba would be to take advantage of such an opening.

Following the collapse of the Soviet Union and the tightening of the U.S. embargo in the early 1990s, the Cuban government declared a “special period” and pursued a number of economic reforms. These measures included legalizing self-employment for a small subset of occupations, opening

public farmland to semiprivate cooperatives, and easing travel restrictions in and out of Cuba to boost the tourism industry. The government also allowed property ownership by foreign joint ventures to help attract more outside investment. According to Hufbauer and Kotschwar, Cuba entered into investment treaties with 61 countries between the early 1990s to early 2000s, and by 2011 there were 245 joint ventures with countries such as Spain, Italy, and France.

But these reforms were short-lived. In the early 2000s, Cuba backed away from more economic openness and began to rely more heavily on economic aid and subsidized trade with allies like Venezuela to cover any economic shortfalls, as it had in the past with the Soviet Union. Such subsidized trade relationships with ideological allies could pose a problem for any American businesses looking to trade with Cuba in the future — although falling oil prices and recent political changes in Venezuela seem likely to diminish its support of Cuba.

In the early 2000s, the Castro government also renewed its limitations on self-employment and imposed new taxes and regulations on foreign investment. “In Cuba, you hear everyone talk about the ‘internal embargo,’ which refers to the self-inflicted policies that do not allow the economy to expand beyond a very limited fringe,” says Carlos Seiglie, a professor of economics at Rutgers University-Newark, and president of the Association for the Study of the Cuban Economy. “These policies don’t take advantage of Cuba’s human capital at all.”

Indeed, skill mismatch is prevalent in the Cuban economy. Despite Cuba’s high education level — the World Bank claims that Cuba has a literacy rate of nearly 100 percent and that roughly 50 percent of the college-age population had attended college or a trade school after high school in 2013 — it is not unusual to find individuals with advanced degrees driving taxicabs or working in hair salons. Such mismatch hurts the Cuban economy and thus limits its capacity to import goods.

A related issue is Cuba’s dual currency, adopted in 1994. Some industries use the convertible Cuban peso (CUC), which is pegged to the dollar, while others use the Cuban peso (CUP), which trades with the CUC at about 25:1. This dual currency system introduces a number of distortions into the Cuban economy and complicates trade and national accounting. In 2013, the Cuban government announced a plan to unify its currencies, but it has not yet set a date for the transition.

Another factor that may limit Cuba’s ability to trade with the United States is its limited ability to earn foreign exchange through exports. “If their purse isn’t very heavy, so to speak, they won’t be able to import very much,” says Zahniser. Many of the industries that once made up the bulk of Cuban exports to the United States, like sugar, have deteriorated in recent decades. Hufbauer and Kotschwar estimated that Cuba’s sugar production has fallen from 82 million metric tons in 1990 to 15 million metric tons in 2012. Additionally, the U.S. quota on sugar represents another barrier to Cuban exports.

Still, Cuba has recently made some efforts to resume economic reforms and open the door to new foreign investment

and trade. Under Raúl Castro, the Cuban government began relaxing restrictions on the sale of private property and private land ownership in 2008-2012. The Cuban government has also worked to repair its trade deficits with other countries, re-entering negotiations late last year with the “Paris Club” (a group of 15 creditor nations) to restructure the \$16 billion in debt Cuba defaulted on in 1986.

Economic and legal negotiations would also be a crucial component of any future trade with the United States. The Foreign Claims Settlement Commission, part of the U.S. Department of Justice, recognizes almost 6,000 claims by firms or individuals on property confiscated by the Cuban government. These claims total nearly \$2 billion, not including any interest that may have accrued since 1960. For its part, the Cuban government has claimed \$121 billion in economic damages resulting from the U.S. embargo. U.S. and Cuban firms also separately claim ownership of trademarks for a number of popular Cuban products, such as Havana Club rum. Still, even on this front things may be moving forward. In December, U.S. and Cuban officials met for the first time to begin discussing claims, and the U.S. Patent and Trademark Office recently ruled that a Cuban government company was the rightful owner of the Havana Club brand.

But in other ways, the Cuban government has been more hesitant. “There’s enormous euphoria on the part of U.S. businesses to work in Cuba, but the Cuban government has not made much effort to engage them,” says Seiglie. “And some in Cuba are concerned that they’re going to lose out on an opportunity as the euphoria dissipates.”

It is a real possibility. While public opinion for ending the embargo has been steadily growing (a Gallup poll last year found that nearly 60 percent of Americans favored ending it), the political climate in the United States is less certain. The Helms-Burton Act codified the embargo into law, meaning that ending it would require an act of Congress, an unlikely scenario before the next election. That means the incoming president could reverse the moves made by President Obama. But many, like Haymore, are cautiously optimistic that pressure from businesses and the electorate will eventually force a change.

“Do I have a timetable or crystal ball? No. But it would be shocking to me to see a huge backpedaling at this point,” says Haymore.

Farmers Lead the Way?

Some American businesses have already started making new inroads into Cuba. At the end of last year, commercial airlines announced plans for regular flights between the United States and Cuba, in response to the Obama administration’s easing of travel restrictions. Tourism to Cuba in general is up — a combination of curious Americans visiting for the first time and other foreigners hoping to see Cuba before it changes too much. A number of U.S. telecoms, such as Sprint, have signed deals to provide roaming services to foreign tourists. The United States also announced last December that it will resume regular postal service with Cuba.

Agricultural firms have a 15-year head start, which provides some insight into the rewards and pitfalls that await other U.S. businesses. They have contended with restrictions from U.S. officials on the one hand and the largely state-directed Cuban economy on the other. Still, Zahniser and his co-authors at the USDA estimate that, if the remaining financial and travel restrictions are lifted, agricultural exports to Cuba stand to grow quite a bit. (In January 2016, the Treasury and Commerce departments lifted most restrictions on financing of authorized, nonagricultural exports to Cuba). They highlighted the Dominican Republic, a country in the Caribbean with similar population and purchasing power, as a possible comparison. Between 2012-2014, the United States averaged \$1.1 billion in annual agricultural exports to the Dominican Republic, more than three times what it exported to Cuba in that period.

Haymore continues to build agricultural trade ties with Cuba; he began the year with another trade mission to Havana, which also included a number of nonagricultural businesses in Virginia looking to enter Cuba. “The Cubans are going to be overwhelmed with U.S. companies interested in exporting again,” he says. “I think that’s why what we have been doing for the last twelve years is so important. We’re a known quantity. We have a trusted relationship. I think Virginia companies who are exporting now and those who are interested in exporting in the future will be able to take advantage of that.”

But, like Haymore, Torres cautions that change is almost certain to come gradually. “These two countries have been apart for a long time, so the legal and physical infrastructure for transactions between the two is not there,” he says. “It will have to be rebuilt from scratch.” **EF**

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