CUBA: EXTERNAL DEBT AND FINANCE IN THE CONTEXT OF LIMITED REFORMS

Luis R. Luis

This paper examines the difficult access that Cuba has to international financial markets in the context of incomplete reforms. After a review of the relationship between reforms and creditworthiness in transition economies, the paper analyzes the current situation of Cuba's external debt and finance. Market source financing is examined in the light of international banking statistics. Next, trade and project finance from friendly nations is surveyed. An overview of the external debt is followed by a look at economic policies that should help improve creditworthiness.

CREDITWORTHINESS, DEBT AND REFORM IN TRANSITION ECONOMIES

In this section I examine the relationship between creditworthiness, debt and reform in transition economies. This particularly concerns external credit. Although domestic credit is also important, economies at an early stage of transition have incipient domestic capital markets and government borrowing is largely derived from the banking sector including the central bank. This in turn is driven by regulations, target lending and compulsory reserve requirements and is not a clear reflection of credit quality. So it is external creditworthiness that one must assess as the leading indicator of credit quality.

External creditworthiness refers to the measurement of a government's willingness and ability to service external debts. It is a function of sovereign risk or the risk that a government will not fulfill its debt service obligations denominated in foreign currency on a timely manner. There are many elements involved in the evaluation of sovereign risk and creditworthiness. The most important elements involve the amount of foreign currency debt and its relation to overall exports, the level of interest rates, the path of economic growth and the degree of economic stability as measured by current and expected inflation rates.[1] These elements statistically explain between 75% and 80% of the variance of credit ratings of emerging countries set by Standard and Poor's (S&P) and Moody's, the two leading credit rating agencies. Credit risk in transition economies is determined by the same variables as in emerging countries with market access. Transition economies include countries such as Cuba with little access to international financial markets that often lack a credit rating from major agencies.

Table 1 shows vulnerability, transition and credit indicators for transition economies including Cuba. The two vulnerability indicators are external debt and gross international reserves as a ratio of GDP. The transition indicators are derived by the European Bank for Reconstruction and Development (EBRD) and by the author on the basis of the EBRD methodology. Credit ratings are from S&P. Cuba's external debt for 2011 is the debt reported by the Paris Club of 19 creditor nations plus debt to international banks as reported by the Bank for Interna-

1. L. R. Luis, "Emerging Fixed Income and Local Currency," in F. Fabozzi and E. Pilarinu (eds.), *Investing in Emerging Fixed Income Markets*. New York: John Wiley and Sons, 2002, pp. 90–92.

Table 1. Vulnerability, Transition and Credit Ratings for Transition Countries (December 2011 and March 2013)

	External Debt/GDP[a]	Gross Reserves/ GDP[a]	Transition Indicators[b]	S&P Rating[b]
Albania	33.7	18.3	21	B+
Armenia	70.7	16.5	20.7	BB- (F)
Azerbaijan	7.3	16.5	17.3	BBB-
Belarus	62.5	14.8	13	B-
Bosnia and Herzegovina	46.5	19.9	18.3	B
Croatia	94.9	23.2	22.3	BB+
Egypt	13.1	6.1	17.2	B-
Georgia	58.5	20.3	21	NA
Hungary	123.5	38.3	24.3	BB
Jordan	59.9	28.7	20.1	BB
Kazakhstan	66.5	15	18.3	BBB+
Kyrgyz Republic	80.8	31.9	20.3	NA
Latvia	137.2	22.5	23.7	BBB
Lithuania	76.1	19.1	23.7	BBB
Macedonia	65	21.5	21.3	BB
Moldova	64.4	33.1	19.7	NA
Mongolia	109.1	29	20.7	BB-
Montenegro	94.6	11	19.7	BB-
Morocco	31.5	15.2	20.2	BBB-
Romania	68.4	20.5	22	BB+
Russian Federation	27.6	27	20	BBB
Serbia	84.9	27	19	BB-
Tajikistan	48.1	4	17.3	NA
Tunisia	51.4	15	19.4	BB
Turkey	39.6	11.8	21.3	BB
Turkmenistan	7.3	NA	10.7	NA
Ukraine	76.4	17	19.7	B
Uzbekistan	13.3	30.3	13.7	NA
CUBA	62.6	6	8.2	NA
Average	61.2	19.8	19.1	

Source: EBRD database, Standard and Poor's and estimates by the author for Cuba.

a. External Debt and Gross Reserves at December 2011.
b. Transition Indicators and S&P ratings as of March 2013.

tional Settlements, debt to suppliers as reported by the Central Bank of Cuba, the estimated value of defaulted bonds and loans and an estimate of debt owed to Brazil and China. In this calculation Cuban external debt was $43.1 billion or 63% of GDP at the end of 2011, slightly over the average of transition economies in the EBRD sample.[2] Debt to Venezuela is unknown. While some analysts estimate it to be sizable following the terms for oil imports indicated in the Venezuela-Cuba Integral Cooperation Agreement, accruing of Cuban services to Venezuela offsets the value of petroleum imports. The accounting of financial transactions and clearing arrangements between the two nations is not public, and there is limited information to make a reasonable estimate. The available information indicates limited credit accumulation on the part of Venezuela's state oil company vis-a-vis countries with which it has energy cooperation agreements.[3] Even as there may be some financial debt to Venezuela, Cuba has very fa-

2. See Table 5 below.

3. Financial statements from Petróleos de Venezuela for 2011 indicate an increase in financial assets attributed to all countries with energy cooperation agreements (including Cuba and all Petrocaribe signatories) of only $1619 million. PDVSA, *Informe Annual de Gestión*, Caracas, 2011, p. 231.

vorable terms for oil import obligations, enjoying grace periods, long maturity (25 years) and low interest rates (2% or less). It is not unrealistic to assume that the current or future Cuban government will value debt owed to Venezuela at a price approaching zero.

Recently the Russian government announced the forgiveness of Cuban debt to the Soviet Union which is estimated at over 75% of the $30.5 billion debt owed to the Paris Club at the end of 2011.[4] An exact amount has not yet been disclosed by the government of the Russian Federation. This debt forgiveness would reduce the amount of debt outstanding of Cuba by a sizable amount, at least $23 billion, which would make Cuba's debt burden substantially below the average for transition economies.

Cuba's international liquidity as measured by the ratio of gross reserves to GDP is well below the average of transition economies at 6% versus 20% of GDP.[5] Only Tajikistan has a lower level of international liquidity, and Egypt is the only other economy among the 28 countries analyzed with a ratio below 10% of GDP.

I also calculate a transition indicator for Cuba based on the EBRD methodology which at 8.2 is the lowest of the sample. This means that Cuba is further away from being a full market economy than any other transition country in the EBRD universe. In the following section I explain the calculation of the transition indicators for Cuba.

A test by means of a regression of the S&P credit score on the vulnerability and transition indicators showed that the transition indicator was significant at the 95% level and accounts for 25% of the variance of the S&P credit rating. This provides evidence of the relation between transition progress and creditworthiness.

SCORING CUBA'S TRANSITION

Cuba under Raúl Castro is undertaking economic reforms, allowing some private small business, shifting labor from the state to the private sector, freeing selected retail prices, improving management of state enterprises and allowing purchase and sale of residential housing and cars among private parties. I gauge Cuba's progress in economic reforms using as a standard the Transition Indicators of the EBRD. These indicators measure progress on the way to the establishment of a fully operating market economy.

Gauging Cuba's economic reforms by means of the EBRD Transition Indicators can be deemed inappropriate. After all it is the stated purpose of the Cuban government to update socialism and not to engage in steps to establish a market economy. In other words, the official policy firmly states that Cuba is not pursuing a "transition" to a market economy. As Raúl Castro famously said in a speech to the National Assembly in February 2009, "I was not elected to restore capitalism in Cuba." Nonetheless, it is useful to make an analysis of the present state of Cuban reform as if it were on the road to establish a market economy and to provide a comparison with transition economies in Eastern Europe, Central Asia and the Near East as measured by the EBRD indicators. Progress on the long road to a market economy can be gauged.

The transition indicators gauge progress in six policy areas: large scale privatization, small scale privatization, governance and enterprise restructuring, price liberalization, trade and foreign exchange system and competition policy. A scale of 1 to 4 is set for each of these areas basically indicating movement between little progress (1) and standards of advanced market economies (4 or 4+ in some areas). I used the methodology of the EBRD in gauging progress in each of these six areas. Table 2 shows the scoring with a succinct explanation of its meaning taken directly from the EBRD methodology.

Progress in most of these areas is slow with a score of 1 for both large scale privatization and competition policy, areas which have seen no reform policies or even aspirations of reforms in the *Lineamientos* or

4. Club de Paris, *Annual Report*. Paris, 2012.

5. Cuba's gross reserves as measured by assets at BIS reporting banks were $4.1 billion at the end of 2011.

Table 2. Scoring Transition Indicators for Cuba (June 2013)

Indicator	Score	Description
1. Large scale privatization	1	Little private ownership
2. Small scale privatization	1.5	A score of 2 is substantial share privatized
3. Governance and enterprise restructuring	1.7	A score of 2 is moderately tight credit and subsidy policy, weak enforcement of bankruptcy laws and little action to strengthen competition and corporate governance
4. Price liberalization	2	A score of 2 is some lifting of price administration, and state procurement at non-market prices is substantial
5. Trade and foreign exchange system	1.2	A score of 1 is widespread import and/or export controls
6. Competition policy	1	No competition legislation and institutions
Total	8.4	

Source: Score by author on the basis of "Transition Indicators Methodology," EBRD, London, 2012.

policy guidelines approved in 2011 by the communist party and the Cuban legislature. A bit of progress can be seen on small scale privatization with 1.5 and governance and enterprise restructuring, though this is probably generous. Price liberalization is one area where more progress has been made especially in retail pricing by private farmers and the self-employed.

The sum of indicators for Cuba is 8.4, which is below any of the 34 transition countries where indicators have been calculated using the EBRD methodology. The lowest rating among those countries is Turkmenistan (10.7), followed by Belarus (13) and Uzbekistan (13.7).

The transition indicators are useful as a guide for policy inasmuch as one interprets Cuba's "updating of socialism" as movement towards a partial or full market economy. The score shows how little has been done and where to place efforts even in areas such as small scale privatization which are at the forefront of Cuban policy.

The low transition indicator for Cuba is evidence of the slow speed of economic reforms. This can be ascribed to deliberate policy decisions that constitute "updating of socialism" as described by leaders of the communist party. This raises the question as to the kind of political and governance reforms required to help speed up economic reforms and liberalization.

While Cuba is unrated by the credit rating agencies, it would be classified in the "CCC to C" range at S&P and Moody's (Caa to C). These ratings denote that the country is in default of its external obligations. Cuba has been in default continuously since 1960 on debt to international banks and on external bonds. It has also been in default on its bilateral debt to Western European governments, Canada and Japan as well as on debt to Russia and other Eastern European nations formerly members of the Council for Mutual Economic Assistance (COMECON).

Cuba is not a creditworthy country. It has little access to international financial markets. While this follows from its history of default and a current situation of non-payment and delays to many suppliers, the slow pace of reform also adds to the Island's problem of accessibility to international finance.

MARKET SOURCE FINANCING

Cuba has no access to long-term commercial finance other than from official lenders in friendly nations. The Island has access to short-term finance from international commercial banks by means of transactions secured by Cuban foreign bank assets or guaranteed by third parties, for example government or state agencies of Brazil, China and Venezuela.

Table 3 tells the story between 2000 and 2012 of financing to Cuba by international commercial banks of 43 nations and offshore centers that report to the Bank for International Settlements (BIS). Although the BIS currently does not provide data on the maturity structure of this debt, previous BIS data indicated that it consisted largely of maturities of less than two years.[6] At the end of 2012 bank financing amounted to $1.4 billion, a little less than the $1.5 billion reported for December 2000, in spite of sub-

6. BIS, *Quarterly Reviews*, 2005–2009.

Table 3. External Assets of BIS Reporting Banks to Cuba, 2000–2012[a] (in $ million)

Date (Year-Month)	Nominal	Δ nominal	Δ exchange rate adjusted	Adjusted Stock[b]
Dec 2000	1572		-735	1572
Dec 2001	1843	271	327	1899
Dec 2002	2008	165	-32	1867
Dec 2003	2687	679	-89	1778
Dec 2004	2307	-380	-489	1289
Dec 2005	2461	154	244	1533
Dec 2006	2512	51	-65	1468
Dec 2007	2935	423	246	1714
Jun 2008	2240	-695	-819	895
Sep 2008	2254	14	184	1079
Dec 2008	1932	-322	-247	832
Mar 2009	1779	-153	-82	750
Jun 2009	1750	-29	-121	629
Sep 2009	1724	-26	-87	542
Dec 2009	1984	260	277	819
Mar 2010	1760	-224	-151	668
Jun 2010	1628	-132	-40	628
Sep 2010	1733	105	-19	609
Dec 2010	1812	79	90	699
Mar 2011	1870	58	-20	679
Jun 2011	1878	8	-24	655
Sep 2011	1718	-160	-59	596
Dec 2011	1662	-56	-15	581
Mar 2012	1654	-8	-48	533
Jun 2012	1456	-198	-135	398
Sep 2012	1421	-35	-71	327
Dec 2012	1386	-35	-49	278

Source: Bank for International Settlements, Quarterly Reports, 2000–2012.

a. Banks of 43 BIS reporting countries including offshore centers and Brazil.

b. Exchange rates as of December 2000 and weights of the previous period.

stantial price increase of major Cuban imports such as foodstuffs and medical products. Adjusting for variations in exchange rates the stock of finance from these banks shriveled to less than $300 million from $1.57 billion. The exchange rate effect was magnified by a switch in the currency composition of loans away from the U.S. dollars to appreciating currencies such as the euro and the Canadian dollar. In nominal dollar terms the fall in available finance was much less pronounced.

Loans from banks reporting to the BIS are covering a dwindling proportion of Cuban imports that require convertible currencies for payments as shown on Table 4.[7] While in 2005 BIS loans to Cuba covered 60% of convertible imports, the figure for 2011, the latest year for which detailed import data is available, was just 30%. It is possible that BIS credit lines suffice to provide import finance from countries for which special bilateral arrangements are not available. More likely it means that Cuba is having to use cash for an increasing proportion of its trade or, less likely, improved access to supplier finance. The latter is probably constrained after the large payments arrears of Cuba to many suppliers in 2008–2012 as a consequence of the sharp weakening of external accounts following the international financial crisis and dwindling Venezuelan financial assistance during that period.

Table 4. BIS Loans as Proportion of Convertible Imports 2005–2011(million US$)

	A	B	A/B
	BIS Loans	Convertible Imports	Proportion
2005	2461	4133	0.60
2006	2512	4912	0.51
2007	2935	5346	0.55
2008	1932	6870	0.28
2009	1984	4128	0.48
2010	1812	4162	0.44
2011	1662	5577	0.30

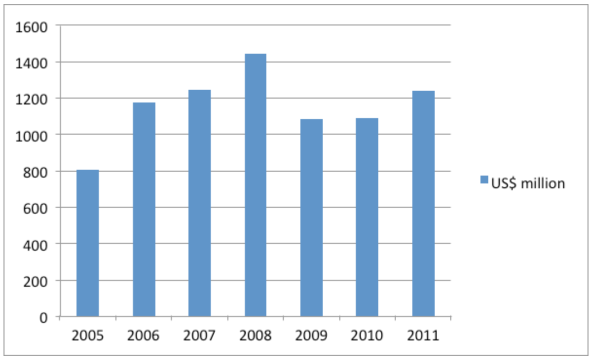
Source: Calculated from data from BIS and from Oficina Nacional de Estadísticas.

TRADE AND PROJECT FINANCE FROM FRIENDLY NATIONS

Cuba's international trade is changing markedly. There is a growing concentration of trade with a small group of friendly countries, the most important of which are Venezuela, China, Brazil and Russia. These countries plus five others of lesser importance (Angola, Bolivia, Ecuador, Nicaragua and Vietnam) in 2010 and 2011 comprised about 59% of the Island's total merchandise trade up from 42% in 2005.

7. Convertible currency imports comprise countries for which either barter arrangements or sizable bilateral finance is not available. It represents imports for all countries except Angola, Brazil, Bolivia, China, Ecuador, Nicaragua. Russia, Venezuela and Vietnam.

Figure 1. Implied Trade Finance from Barter Countries[a]



Source: Estimates by author from ONE trade data.

a. Excludes Venezuela

I label trade with these friendly countries "barter trade" as indicated by sizable barter transactions and deep concessional financing to Cuba from these countries. There are also market transactions with some of these countries, particularly with firms in Brazil and China involving food and other consumer goods imports. There is little available data to disentangle barter and concessional trade from market trade, so that I consider as "barter" all trade with Brazil and China. Trade with the ALBA countries (Bolivia, Ecuador, Nicaragua and Venezuela) is subject to bilateral trade agreements involving barter and state financing with opaque compensation and clearing mechanisms.

The dollar value of barter trade between 2005 and 2011 rose at an average annual rate of 19.4%. Even excluding Venezuelan trade, dominated by petroleum imports, it expanded at a rate of 11.4% per year. This is in sharp contrast to the trend in convertible trade, or trade at market conditions with the rest of the world, which showed an average annual increase of 6.3%.[8]

I calculate implied trade finance with barter countries. This estimate involves the assumption that merchandise imports from "barter" countries except Venezuela are financed at a term of 180–days. A shorter term would mean a lesser amount of trade lines. Figure 1 shows the resulting trade lines for 2005–2011.

Implied trade finance from barter countries peaked at a bit over US$1.4 billion in 2008, falling substantially in 2009 and 2010 to less than US$1.1 billion per year. Trade lines then recovered in 2012 to US$1.2 billion. The figures denote stagnation in imports from friendly countries and in parallel trade finance.

The dynamics of trade and finance with Venezuela are unique. Cuba is involved in barter trade with Venezuela, the dollar amount of which is basically driven by oil prices. Cuba is allowed imports of 98,000 barrels per day of crude oil at preferential prices determined by an integral cooperation agreement between the two countries.[9] However in practice oil is imported in exchange for the services of more than 40,000 health, education, security and other advisors. Venezuela provides financing for Cuba's oil imports. But the value of Cuba's service exports to Venezuela exceeds its oil imports meaning that in recent years Cuba is not receiving finance for petroleum imports. Though the bartering of oil for services is at the heart of Cuban-Venezuelan trade, the cooperation agreement between the two countries involves many projects and joint ventures that are financed by Venezuela.

Other friendly nations in addition to Venezuela provide project and other long-term finance to Cuba, most notably Brazil, China and Russia. There is scant information about these projects as well as well as financial details of joint projects with Venezuela. Information in the press is not always reliable. Information for major projects such as the renovation of the Cienfuegos oil refinery in 2009–2011 with capacity of 50,000 barrels per day indicate an initial estimate of US$50 million. A later letter of intent between Cuvenpetrol, the joint venture between Cuba and Venezuela that operates the refinery, and China National Petroleum Company aims at further expanding the refinery to 150,000 bpd from 65,000 bpd of

8. These calculations are based on data from Oficina Nacional de Estadísticas.
9. Petróleos de Venezuela S.A., *Informe de Gestión Anual 2011*, pp. 176–177.

current capacity.[10] No firm financing for this project has yet been announced. The trans-Caribbean optical cable between Cuba and Venezuela was estimated to have cost $70 million.[11] There is little financial information about the more than two dozen joint investments between Cuba and Venezuela.

Brazil has provided a number of important credits through the Brazilian Development Bank (BNDES) for imports and specially construction financing for the revamping and expansion of the port of Mariel and related infrastructure, a project undertaken by Odebrecht, the Brazilian engineering and construction company. BNDES is to supply credit of $682 million through the year 2016.[12]

The Russian Federation provided in 2013 financial guarantees of up to $550 million for long term leases of aircraft owned by Ilyushin Finance.[13] Originally Cuba had signed a letter of intent to purchase a number of AN-148, AN-158 and IL-96 aircraft manufactured in Russia and the Ukraine. The transaction was converted to a lease arrangement which softens the financial burden on Cubana, the operator of the aircraft.

EXTERNAL DEBT OF CUBA

Cuba has been in default with most private and official creditors since the early 1960s. As a consequence active external debt or debt that is currently being serviced is a part of total external liabilities. Furthermore, the default status of a sizable portion of the debt implies that creditors also claim past due interest on defaulted obligations. Capitalizing interest gives rise to a further layer of claims. A substantial portion of the official debt is owed to friendly countries such as China, Russia and Vietnam which have divulged little information about Cuban liabilities. This means that gauging the precise amount of Cuban debt is not an easy task. Compiling existing information will inevitably leave gaps arising from longstanding claims and from the absence of public information.

The approach here is straightforward. I have collected data from major reliable sources for banking debt (BIS), official bilateral debt from the Paris Club, suppliers' debt from the Cuban government and estimates from the face value of obligations to the London Club of commercial banks. The numbers also include rough estimates of obligations to friendly nations not covered by the Paris Club based on press reports of project finance by Brazil, China and Russia (Table 5).

Table 5. Cuban External Debt by Creditor (US$ billion)

	December 2011	June 2013
BIS banks	1.7	1.4
Paris Club[a]	30.5	12.2
Other Official Debt[b]	2.0	2.3
Suppliers[c]	4.6	5.0
Defaulted Bonds and loans[d]	4.3	4.3
Total	43.1	25.2

Source: BIS (*Quarterly Review,* various*), Paris Club* (*Annual Report* 2011 and 2012), Oficina Nacional de Estadísticas, Exotix and author estimates for June 2013 and suppliers debt

a. Official debt from 19 major creditors nations
b. Brazil, China and other official debt not in Paris Club. Estimate by author based on reported projects
c. Estimate based on data from ONE for end 2009
d. Defaulted bonds and commercial loans carried at face value. Includes $1.25 billion from London Club

Cuba had external obligations of $43 billion at the end of 2011. Some 71% of these obligations were due to the Paris Club of 19 nations, the most important of which consisted of debt and interest due to Russia mainly associated with Soviet era credits. The second largest component is supplier's debt at $4.6 billion and derived from ONE data. This number does not include past due interest from arrears arising in 2008–2011 when Cuba suspended payments and froze bank accounts of many suppliers. Table 5 reports defaulted bonds and loans at face value. Capi-

10. "China signs letter of intent to redo Cuba refinery," Reuters, June 5, 2011.
11. "Broadband cable on its way to unplugged Cuba," *The Guardian*, January 23, 2011.
12. BBC Brasil, January 12, 2012.
13. *Russian Aviation*, June 11, 2013.

talization of interest will increase the amount claimed by creditors, but there is no detailed information on loan and bond covenants to accurately capitalize defaulted obligations.

A major change in Cuba's external debt is taking place this year as Russia agreed to settle Soviet era loans. I have incorporated this agreement into calculations of debt due as of mid-year 2013, although final documents will not be signed until late 2013. The agreement calls for writing off and refinancing somewhat over $30 billion in debt, according to Denis Manturov, Russian Minister of Trade and Industry.[14] Soviet era debt may be reduced by some $24 billion based on a 75% reduction of outstanding claims. Some of this will be offset by obligations to Russia arising from credits granted this year.

Following this accounting and taking into consideration reported debt additions by members of the Paris Club,[15] Cuba's overall external debt would be $25.2 billion or 36% of GDP. This is equivalent to 146% of exports of goods and services as reported by the Cuban government, which includes the value of health services exports to Venezuela and other countries in Latin America and Africa. Such a level of debt would be sustainable as it is below the 200% level that shows a high probability of debt service difficulties. However when debt is calculated as a percentage of convertible current account receipts that include convertible exports, tourism and remittances the number rises to 356%, an unsustainable level.

IMPROVING CREDITWORTHINESS

Cuba needs to restore access to international finance to complement low domestic savings and sustain growth. Helping restore access requires changes in Cuban and foreign policies. While changes in U.S. restrictions are an important part of opening access, I center here on Cuban economic policies that would help improve creditworthiness. Surely democratic reforms are even more important than economic reforms and very likely would strongly help change U.S. policies towards Cuba. This appears not to be in the medium-term horizon.

Cuba's low credit standing is mainly a function of ineffective domestic policies that fail to raise international competitiveness. As mentioned in the previous section, the external debt is very high when measured against hard currency exports but not so high when considering total current account receipts. Importantly, as I showed in the first section of this paper, evidence indicates that progress on the way to a full or partial market economy is associated with improving creditworthiness. By measure of the EBRD Transition Indicators Cuba is a long way towards attaining investment grade standing or at least an S&P rating of BBB-. The average BBB range Transition Indicator in the EBRD sample is 19.0, more than twice Cuba's score of 8.2.

What should Cuba's policy priorities be? The deepening of current reforms is the clear way to proceed. Small scale privatization and price liberalization are good targets given initial efforts in these areas. Large scale privatization and competition policies are nonexistent and need to be addressed rapidly in combination with a much greater opening to foreign direct investment. Enterprise governance would need to be coordinated with large scale privatization to be able to establish deep reform.

External sector policies are the most directly linked to creditworthiness and here policy changes and aspirations of change in the *Lineamientos* are vague. Currency rationing, multiple exchange rates, import budgeting, export taxes, inflexible rules for foreign investment, rigid labor contracts for foreign companies and others constitute barriers to international competitiveness and have been amply covered in the

14. *Pravda*, February 22, 2013.

15. The Paris Club reports an increase of Cuban debt of $4.6 billion in the year to the end of 2012. Paris Club, *Annual Reports*, 2011 and 2012.

literature of Cuban reform.[16] In addition, irregular payment to suppliers and the freezing of payments and royalties due to foreign investors has degraded the image and perception of Cuba as a viable destination for foreign direct investment and an unreliable partner in ventures and commercial relations.

As regards international commercial relations, Cuba is functioning increasingly in a closed system with friendly nations, driven more by political relations than by economic and commercial considerations. While some of these relations may prove to be beneficial if they are associated with export-oriented projects, others notably the critical Cuba-Venezuela relationship is based on a political relationship rather than on competitive considerations and fosters dependence on the persistence of a friendly government in Caracas.

Normalization of Cuba's international debt and finance is a priority and a condition to restore international commercial relations. Membership in international economic institutions, most importantly the International Monetary Fund and World Bank, would be required to negotiate a settlement with the Paris Club. Negotiations with commercial banks and bondholders should follow. This will require the establishment of a settlement fund to provide negotiated compensation to creditors now in default. Lastly, Cuba faces claims adjudicated by courts in the U.S. that also need to be addressed. Otherwise Cuba's export receipts and other receivables would be in reach of judicial attachment. A separate settlement fund for these purposes would have to be established. Some financing for these funds may be available from foreign countries willing to assist Cuba in the normalization of its external financial relations.

As a first step Cuba could also look at raising commercial financing by means of collateralized loans or small bond issues. Collateral could be provided by future export receivables, for example, nickel or flows from European tourist expenditures.

CONCLUSION

Cuba scores very low on both progress towards a free market economy and international creditworthiness. The government needs to energetically deepen free market reforms as a means to improve competitiveness and restore creditworthiness. It is not clear that this can be achieved without political and governance reforms in the island. The current slow approach to reforms and liberalization may be consistent with maintaining the political status quo on a limited horizon. It is not consistent with a restoration of creditworthiness and access to international capital markets.

16. See J. Pérez-López, "Cuba's External Sector and the VI Party Congress," *Cuba in Transition—Volume 21*, 2012 and Pavel Vidal, "Monetary and Exchange Rate Reform in Cuba: Lessons from Vietnam," Institute of Developing Economies, Tokyo, 2012.