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The Cuban Thaw

On Wednesday, December 17, 2014, President Obama surprised the country by announcing a prisoner exchange and negotiations to begin establishing diplomatic relations with Cuba. Given that the Eisenhower administration broke off diplomatic relations with Cuba in January 1961, even considering resuming relations is a major change in policy. In this report, we will discuss the importance of Cuba to the geopolitics of the U.S and offer a short history of the island along with a summation of the lessons of that history. We will analyze the limits of the current thaw and why this attempt at *rapprochement* is occurring now. As always, we will conclude with potential market ramifications.

U.S. Geopolitics and Cuba



(Source: Wikipedia)

This map highlights the U.S. central river system, the “crown jewel” of American

geography. The Mississippi River acts as a central corridor that connects the Ohio, Missouri, Tennessee, Arkansas and Red Rivers, allowing for large scale farming of the central plains. Much of this land came under U.S. control with the Louisiana Purchase and was completed when Texas joined the Union in 1845, although it wasn't secured until after the Mexican-American War ended in 1848.

The key to effectively utilizing the central U.S. river system was protecting New Orleans and ensuring that no outside power could bottle up shipping in the Gulf of Mexico and the Caribbean. For much of the 1800s, the U.S. fended off encroachment from both Spain and Britain. Andrew Jackson routed the British at the Battle of New Orleans in 1814, a battle that was part of the War of 1812. The U.S. ousted the Spanish from Florida, organizing the area into a territory; again, Andrew Jackson led a campaign against the Seminole Indians in what is now eastern Florida in the First Seminole War in 1817-18.

Despite a secure American mainland, European powers still threatened U.S. shipping from New Orleans in the Yucatan Straits. The narrow passage between the Florida Keys, the Yucatan Peninsula and Cuba could be used to interdict American shipping. Thus, the U.S. needed to ensure that Cuba was not controlled by a hostile power.

It should be noted that President Jefferson considered possessing Cuba and conducted back channel negotiations with the Spanish governor to annex the island in 1805. In 1823, then Secretary of State John Q.

Adams argued that Cuba should be in U.S. hands and strenuously fought against British incursions in the Caribbean.

By the 1870s, after slavery was abolished in Cuba, industry had been transformed. Without low cost labor, sugar and other crops were industrialized, supported by American capital. Although Cuba remained in Spanish hands, its economy was becoming increasingly dependent on the U.S.

By 1881, Jose Marti began mobilizing Cuban exile support in the U.S. for independence. Marti, a Cuban hero, opposed continued Spanish rule but also wanted to prevent American annexation. Over the next 15 years, Marti and other revolutionaries attempted to overthrow the Spanish colonial government, but these efforts failed to oust the Spanish government. To defeat the rebels, Spanish troops deployed harsh methods, including executions, exile and the destruction of private property. These atrocities created great sympathy in the U.S. for the rebels' struggles, reminding many Americans of its founders' conflicts with the British for independence.

As the civil conflict escalated, the U.S. became concerned about the safety of Americans living in Cuba. President McKinley sent the U.S.S. *Maine* to Havana in 1898. The ship exploded in Havana's harbor; although there is still dispute over how the ship was destroyed, the American press implied it was Spain that was responsible and wanted war. President McKinley did not want a conflict but did want to send U.S. troops to Cuba to end the civil war. Congress overwhelmingly supported sending troops. However, part of the agreement to send troops included the Teller Amendment, which stipulated that the

U.S. could not annex Cuba but only leave "control of the island to its people."

As the U.S. Navy deployed a blockade, American troops moved into rebel-controlled areas in Cuba. The Spanish-American War was underway. After several months, Spain surrendered and by the summer of 1898 had sued for peace with the U.S. Cuba was no longer part of the Spanish Empire. However, due to the Teller Amendment, it wasn't part of the U.S. either. Still, the McKinley administration established an occupying government led by the U.S. Army. Representative institutions established by Cuban revolutionaries were disbanded.

By the turn of the century, American investment had begun to pour into Cuba. Railroads were built with American capital and the sugar cane industry was expanded and modernized. By 1902, 40% of sugar cane production was controlled by North Americans.

Into the early 20th century, the U.S. military began the process of establishing a Cuban government. Political parties were established and municipal elections were held. However, the Platt Amendment, which was part of the legislation to end military occupation, severely restricted Cuban independence. It gave the U.S. the power to intervene in Cuban affairs and limited Cuba's power to deal with other foreign governments or investors. It also established a U.S. naval base in Guantanamo Bay.

Into the 1920s, the U.S. sent troops into Cuba on several occasions, ostensibly to protect American investment and to quell unrest. Elections were held until Gen. Gerardo Machado, who was first elected in 1925, decided to stay in power, making

Cuba a dictatorship. He was ousted in a revolution in 1933; the U.S., likely distracted by the Great Depression, did not interfere. A new government, led by Dr. Ramon Grau San Martin, took power. He liberalized labor laws and rejected the Platt Amendment. This new government didn't last long; by early 1934, a coalition of right-wing civilian and military elements took power, led by Fulgencio Batista and supported by the U.S. He won elections in 1940 but was replaced by Grau in the 1944 elections. Carlos Prio Socarras won the presidency in 1948. Eduardo Chibas, the leader of the Orthodox Party, was expected to win in 1952, running as an anti-corruption candidate. The young Fidel Castro considered Chibas his mentor. However, Chibas committed suicide after he promised to reveal high-ranking political figures' corrupt activities on his weekly radio show but then failed to do so. In the political vacuum, Batista led a bloodless coup to take control.

It should be noted that by the early 1950s, Cuba's GDP was roughly the size of Italy's and its industrial wages were the eighth highest in the world. Its agricultural wages exceeded those of West Germany and France. It had more doctors per capita than the U.K. and the lowest infant mortality rate in Latin America. Cuba's close connections with the U.S. economy were the primary reason for its strong economic performance.

By the late 1950s, Batista's corruption and dictatorial behavior led to rising opposition, including from Fidel Castro. Although Castro was not initially successful in his efforts to overthrow the government, widening discontent with Batista, along with the Eisenhower administration's decision to impose trade restrictions to encourage the dictator to leave the country, led to Castro's revolution.

Castro became increasingly radicalized; although some historians have argued that his affinity for Chibas shows he was not always a radical communist, he quickly became one once in power. He swiftly consolidated power and threatened those who opposed him, causing a mass exodus of opponents who mostly settled in Florida.

President Eisenhower, who had decided that Batista was a liability, quickly realized the situation had worsened under Castro. As noted above, Eisenhower broke off diplomatic relations and began embargoing trade. His successor, President Kennedy, further restricted trade and supported the failed Bay of Pigs invasion. However, the real crisis that developed was the Cuban Missile Crisis in 1962.

The Soviet Union had a serious deterrent problem. The U.S. had a deep long-range bomber fleet due to its experience from WWII. The U.S.S.R. generally only conducted short- and medium-range bombing during the war and could not deliver nuclear weapons effectively by airplane. Despite the Sputnik scare, the Soviets were behind the U.S. in intercontinental ballistic missile (ICBM) technology. On the other hand, the Soviets had a well-developed intermediate missile fleet; they simply needed a place to base these missiles close to the U.S.

Castro's Cuba became that venue. As the trade embargo began to undermine Cuba's economy, Castro needed an economic patron. Russia needed a missile base.



(Source: Wikipedia)

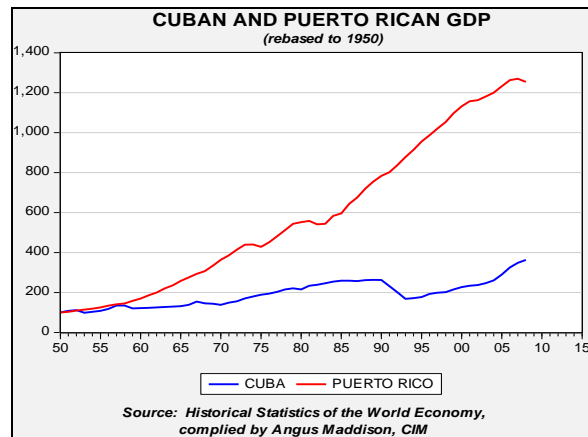
However, before the Soviets could fully deploy their missiles, U.S. spy planes recorded their efforts. For a few days, the world became dangerously close to nuclear war. In the end, the U.S.S.R. backed down, agreeing not to place missiles in Cuba. Later, the U.S. removed nuclear missiles from Turkey as a quid pro quo.

From this point forward, Cuba’s economy became increasingly dependent on Soviet trade. Politically, the Castro regime allowed no opposition, regularly imprisoning dissidents. Persistent waves of refugees made the “float” from Cuba to Florida to escape either political oppression or economic stagnation. The collapse of the Soviet Union in the early 1990s led to a severe economic crisis in Cuba that was only partially offset by cheap oil from Venezuela. The communist system in Cuba discouraged investment and individual initiative, and thus growth slowed. However, despite communism’s obvious failings (as seen by Cuba’s current economic position compared to its relative strength in the early 1950s), Castro has always been able to blame the American economic embargo for the island’s ills.

Lessons of History

The primary lessons from Cuban-American relations are as follows:

- Cuba is of key geopolitical importance to the U.S. Sea lanes from New Orleans to the Panama Canal are at risk if Cuba is held by a hostile power that wants to interfere with critical U.S. trade.
- The U.S. is clearly unsure of how to deal with the island. There was an almost romantic view of Cuba as a smaller version of the founding narrative of the United States. At the same time, in practice, the U.S. was intent on directing the governance of the island. Nearly constant interference in the first half of the 20th century has supported anti-American movements and may be the main reason Cubans have tolerated Castro’s behavior since the late 1950s.
- Although Cubans may have chafed under American political interference, the Cuban economy did benefit from its close proximity to the U.S. The drop in economic performance since Castro took office is the cost of severed relations with the U.S.



This chart shows Cuban and Puerto Rican GDP indexed to 1950. Cuba’s economy was nearly four times larger than Puerto Rico’s in 1950; as of 2008, the last available data, Puerto Rico’s economy is three times larger.

- The Cuban diaspora in Florida has evolved into a political constituency that has kept the economic embargo in place despite little evidence that it was changing Castro's behavior or bringing any semblance of regime change.
- As long as Castro had the U.S.S.R. as his patron, the U.S. could not afford to reduce pressure on Cuba. However, the fall of the Soviet Union changes that calculus.

Why Now?

As often occurs with major diplomatic changes, there were conditions that prompted both sides to adjust. The major points are listed below.

President Obama needed a foreign policy victory. The president has had a difficult time conducting foreign policy. For example, after leaving Iraq, the rise of Islamic State has forced the U.S. to return in a limited fashion. Libya is in chaos after the administration supported the ouster of Kaddafi. Russia invaded Crimea with a less than commensurate response from the U.S. Restoring diplomatic relations with Cuba is a way to regain foreign policy initiative.

There is less support for isolating Castro from the Cuban diaspora. As the Cuban constituency has aged, it has become less monolithic. The political damage for supporting a thaw has been reduced.

Many nations in North and South America see U.S. policy toward Cuba as an anachronism. Easing up on Cuba will help American relations with other nations in the hemisphere. It will also make these nations less tolerant to Cuba's numerous human rights violations.

The U.S. has little to fear from foreign domination of Cuba. With the U.S.S.R. no longer a threat and the Venezuelan economy collapsing under the weight of the misguided policies of Hugo Chavez, Cuba is isolated. With no outside power threatening American sea lanes, the U.S. does not need to isolate Cuba.

Cuba's economy continues to suffer and is threatened by the economic chaos in Venezuela; in fact, the low cost oil that Venezuela provides will probably be ending soon. A modest improvement in relations could boost U.S. tourism and investment, which would help lift growth.

At the same time, with the GOP controlling Congress, there is little chance of the embargo being lifted. An ending of the embargo would be a nightmare for Castro because he could no longer blame his human rights policy or the poor economy on the U.S. Because Castro can rely on the Republicans to not ease sanctions further, Cuba's economy can receive some benefits without the potential upset from a full opening of relations.

For now, we would not expect rapid changes other than improving diplomatic relations. In fact, there is probably more risk to the Castro regime from this opening. After all, it will be tougher for the government to argue that it must constantly clamp down on dissidents because of the fear of the American goal of regime change. As long as the U.S. can prevent any outside power from using Cuba to threaten the sea lanes, the risk to this modest opening is low for America. It should be noted, however, that just because no outside power seems interested in using Cuba to build threats against the U.S. doesn't mean that it can't happen in the future. And so, this thaw with Cuba will likely remain a slow drip unless there is a

regime change on the island or an outside power tries to use the country to threaten U.S. interests, which would lead to a new freeze.

Ramifications

Overall, the resumption of diplomatic relations with Cuba, though historic, is somewhat less than a full normalization. Without the Castros out of government, we do not expect that step to occur. Cuba will benefit from U.S. investment which will, of course, work to undermine the communist ideology that the Castro brothers have used

to rule the island since the revolution. Overall, this change is a modest supportive factor for American agriculture and perhaps the lodging, travel and entertainment industries. However, we would not expect dramatic changes beyond what the current agreement brings.

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