

# The Political Economy of the Cuban Reforms

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## The Political Economy of the Cuban Reforms

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RUDOLF STRUCK, MAY 3 2015

Public speeches of Raúl Castro, leader of the Cuban state and its *Partido Comunista de Cuba* (PCC), usually cause no one to jump out of their seats. Simultaneous announcements by him and US President Barack Obama on 17 December, however, marked a rather unexpected end of the two countries' five-decades long stalemate. Havana and Washington will enter diplomatic contact for the first time since 1961, US regulations on travel and financial transactions are to be loosened and, most importantly, presidential action will legalise exports of certain commercial goods to Cuba, which may be relevant input factors for farmers and entrepreneurs boasting its growing private economy.[i] This potentially ground-breaking move falls within a framework of reform efforts dating back to 2008, when Raúl had inherited leadership from his ailing brother Fidel Castro. During the past five years, public spending has been reduced and revenues increased by decentralising management decisions of the extensive state economy. Complementing these public sector reforms, a low-technology sector of private and cooperative suppliers has been established. Eventually, Cuba, heavily, has attempted to attract foreign investment to be realised in joint ventures with the government. The future holds yet more structural changes that demand a scientific examination, such as the announced but not yet scheduled re-unification of Cuba's double currency system.[ii]

This essay aims to contribute to the discussion by providing a sound theoretical and empirical foundation to the analysis of the future development of the reforms. Caught in the midst of this intriguing development, the academic discussion on this specific issue is still forming, and no canonical body of literature has yet emerged. Instead of a central literature review, the essay eclectically draws on different sources as it goes along establishing the theoretical framework as given by the selectorate model[iii] and the production function of loyalty through benefits and repression.[iv] In a nutshell, it shall argue that Cuba will very likely continue its cautious reforms towards a mixed public-private economic system. In setting the pace and the scope of the market opening, the leadership has to balance the risk of an emerging class of powerful entrepreneurs against the risk of curbing the dynamics of the new sector. In such a setting, without democratic institutions, moderate, yet constant pressure on the regime survival is a necessary condition for the persistence or even deepening of market liberalisation.

First, the essay outlines the political constraints of the reforms as given by the military and communist party coalition. It then proceeds by showing a long term change of how a majority of Cubans trade off individual income, public social services, equality of income and equality of opportunities. Within that context, Raúl Castro's seizure of power compels him to establish his own base of support, which requires a noticeable improvement in the country's economic performance. Subsequently, the essay shows that structural reforms are necessary for the economy to remedy Cuba's shortage of capital. The following section turns to the policies that have been implemented and the power dynamics emanating from them. These insights create the foundations for the discussion of three conceivable future pathways: a continuation of gradual reforms, a return to a more authoritarian model fueled by a positive external shock, and an accelerated transformation to an entrepreneurial-statist coalition.

### The Coalition: Military and Communist Party

After succeeding his brother in office from 2008 to 2011, Raúl Castro reshuffled the composition of various offices, among which are the State Council, the Council of Ministers and the Politburo of the PCC. When it comes to the formulation, implementation and execution of legislation, the three institutions are the power centres of the Cuban state and party,[v] which suggests their composition gives a fairly good approximation of whose interests matter in

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Raúl's winning coalition. Within the wider range of supporters, this coalition usually consists of actors occupying the dominant positions in a political system in as much as they can determine who is in power.[vi] A second relevant piece of theory that explains how leaders create support is Wintrobe's production function of loyalty featuring two inputs: First, give your supporters whatever it is they desire – benefits, henceforth. Second, punish opponents – called repression.[vii]

High ranking generals and revolutionary veterans of the *Fuerzas Armadas Revolucionarias* (FAR) now hold half the vice-presidencies of the State Council. FAR officers also occupy three in seven vice-presidencies of the Council of Ministers.[viii] Furthermore, after the sixth PCC party congress in 2011, they account for almost half of all seats of PCC's Politburo.[ix] Although members of the military had been strongly represented in the Cuban leadership before, Raúl's appointments have escalated this trend and further strengthened the FAR's influence.[x]

Raúl Castro, as a long-standing minister of defence and veteran of the revolutionary war, can draw upon a personal affinity and the loyalty on the side of older FAR generals he appoints. Although Joyce judges the FAR to be 'broadly loyal'[xi] to Raúl, there is a number of cleavages within the army. Many young officers crave for broader career opportunities and faster promotions which create tensions with older veterans; some of whom have been member of FAR since the revolution in 1959.[xii] Younger cadres are already more likely to benefit from the for-profit companies of the FAR and are thus more susceptible to economic incentives than to personal affinity.[xiii] They compete among one another for these perks and rival older (and high-ranking) veterans who oppose this strong role of material incentives in the military and the simmering corruption that the erosion of traditional loyalties has brought about.[xiv] Beginning in the 80s, the leadership has then controlled the army by classical means of carrot and stick and benefits and purges, which indicate the precarious state of their loyalty.[xv] Alongside the economic gains of their export sector, the military's experience in engineering market openings and managerial reforms is a considerable asset to the regime.[xvi] This suggests that their real influence in the process of policy planning and implementation is even greater as their mere presence in the highest offices implies.[xvii] Furthermore, both the FAR and its security apparatus provide for a necessary degree of external security and domestic repression.

Making up the second coalitional group, party technocrats now hold one third of all Politburo seats and are supported by the powerful provincial PCC officials.[xviii] However, in the coalition, the PCC is a junior partner to the FAR and less powerful than it.[xix] The technocrats in office lack an independent power base apart from them being appointed by Raúl Castro. Unlike the FAR, the strengths of the PCC are not in the field of administrative expertise. 'Its greatest effectiveness comes instead from its work in ensuring ideological orthodoxy and control'[xx] through its various organisations straight down to the PCC's neighbourhood watchdogs, the *Comités de Defensa de la Revolución* and various other mass organisations at workplaces etc.

Another significant appointment is José Ramón Machado Ventura, a proven communist hardliner and now second-in-command behind Raúl Castro in all state and party offices. Appointing an 84-year-old deputy avoids the risk of him being a rival, or contender for succession.[xxi] Nonetheless, he occupies a powerful position to voice hardline interests while their actual influence on policy issues is uncertain.

## The Revolutionary Social Contract Expires

The Cuban revolutionary regime derives a portion of its legitimacy from the social pact between population and leadership which prescribes the provision of free education, health services and social security in exchange for unconditional regime loyalty.[xxii] Inevitably, time is working against this natural legitimacy. Despite seemingly unsystematic disturbances of the survey results in 2009, data of the International Republican Institute consistently displays a positively biased political opinion of elder cohorts, especially of Cubans over 60. If given the opportunity to change to a 'westernised' democratic system, 50 percent of the respondents over 60 would vote for the current system compared to 23 percent of those under 30 in 2008. Raúl Castro seems to enjoy an equally skewed support: In 2007, 61 percent of the 60-plus cohort would favour him over some member of the domestic opposition, but a mere 25 percent of all Cubans under 30 would do so.[xxiii] The support on the side of the pensioners demands an explanation insofar as their objective living conditions have deteriorated dramatically during the past 20 years. Although their real pension entitlement has recovered more quickly as compared to the real wages in legal forms of

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employment (in 2011, pensions and wages reached 50 and 27 per cent of the 1989-level respectively.[xxiv]), the elderly in fact belong to those Cubans most at risk to fall into poverty.[xxv] Thus, public opinion evidence suggests the regime legitimacy to have a generational or cohort component that may derive from a shared collective memory of the 1959 revolution and the time after (in the literature, this phenomenon is known as Cuban exceptionalism.[xxvi]) Individuals who grew up in the past 20 years and whose trust in the performance of the revolutionary state is exclusively shaped by the experience of the crisis period already constitute a significant part of the Cuban population. They are certainly less likely to unconditionally defend the regime and will be ever more demanding in exchange for their loyalty.

After all, equality would appear to be one of the most important virtues of the revolutionary society which would be a constraint on the political success of the reforms. Yet, equality of income has effectively ceased to be a widespread experience sometime in the last 20 years and therefore lost moral credibility at least with a number of Cubans. According to Añé's estimates, the GINI coefficient has increased dramatically from 0.24 in the 1980s to 0.38 in the beginning 2000s.[xxvii] On the other hand, asked by Freedom House about their policy preferences between 2010 and 2011, 'those who believed individual economic advancement was more important outnumbered those who prioritized economic equality by a ratio of three to one.'[xxviii] What we observe instead, appears to be much more akin to an instrumental egalitarianism. Espina Prieto and Togores González argue that most Cubans:

Share a negative perception [...] when they compare current Cuban society to that of the 1980s. They point to increased social inequality in general and in particular inequality of opportunities to improve living standards, to weakened social justice, and insecurity and uncertainty about meeting basic needs.[xxix]

In sum, growing income inequality is no primary factor of regime support. Nevertheless, insufficient income expectations and systematically unequal starting positions are and may need to be targeted by the reforms.

## Replacing the Irreplaceable Comandante en Jefe

As it follows from the concept of Cuban exceptionalism, the succession to Raúl Castro marks a reconfiguration of the mode of leadership. While beyond the short term he cannot build his rule on the exceptional legitimacy his brother enjoyed, he has to resort on a leadership model of technical expertise and economic achievements.[xxx] A glance on the Wintrobe's theory of loyalty production suggests this to be his only viable strategy. Although repression is a substitute for benefits, its marginal return is decreasing along the entire production function, which means it creates less additional support as its absolute level rises. With an increasing level of repression, any further attempt to enforce loyalty by coercion may accidentally hit on dissidents and supporters alike as manifest opposition is already defeated.[xxxi] A brief review of the Freedom House reports on Cuba reveals that Cuba's rule of law scores at the lower end of the scale with frequent acts of intimidation and preventative detentions of dissidents, and constantly so.[xxxii] Therefore, a further increase of support among the general population can only realistically be created through benefits, or, in turn, the preferred level of regime stability cannot easily be sustained if a sudden deterioration of the economic situation occurs.

Legitimate doubts have been raised about whether cheap talk about reforms would be enough of a short-term relief to buy some time. This, of course, would depend on the time horizon of the leadership, for instance on whether Raúl Castro has planned for longer than the possibly ten years he will be in charge. In the words of Lopez-Levy:

As result of the stagnation [in the 90s], significant segments of the Cuban population questioned the government's willingness to execute the most needed changes. After twenty years of government announcements and delays; confidence in the leadership's commitment to real reform is shaky.[xxxiii]

Indeed, in the beginning of the reform period, the share of Cubans believing that the 'government will succeed in solving Cuba's biggest problems in the next few years'[xxxiv] started off in 2007 on a mere 19 percent before surging up to 27 percent right after Raúl Castro's appointment in April 2008. Ever since 2009, it has continued to hover just under 20 percent. If there actually occurred a small increase in general trust the new leadership enjoyed, it proved almost a statistical aberration. The Freedom House reports on Cuba widely support this trend. When asked about

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their future expectations in 2008, only 'few Cubans trust that Raúl will implement significant changes in the near future.'[xxxv] The tide appears to turn in mid-2011 when actual economic progress kicks in and feeds back into people's future expectations. '79 percent of respondents have noticed changes in the country over the last six months, particularly the higher number of *cuentapropistas*'[xxxvi] (self-employed workers) which initially left many people with insecurity. Subsequently, the share of people perceiving that the economic situation of their families is at least as good as in the past year rose from 80 to 89 percent, while the proportion of people expecting it will improve in the following year surged from 23 up to 45 percent in the same period.[xxxvii]

## Economic Variables of Regime Support

In addition to four devastating hurricanes striking Cuba in 2008, Raúl Castro's rise to power and the launch of the latest reforms coincided with another negative external shock: the economic turbulences following the financial crisis in Europe and North America tightened the regime's financial constraints when the previously positive trade balance (2.7 percent of GDP in 2007) dropped down to a negative -2.8 percent whereas the influx of foreign capital even decreased by 65 percent altogether. The self-reported output growth significantly slowed down from 7.3 to 1.4 percent between 2007 and 2009 and exacerbated the fiscal deficit to -6.9 percent of GDP in 2008.[xxxviii] Severe fiscal tightening was necessitated as Cuba lacked reserves to counter such a serious macroeconomic shock. In the few years after the liquidity crisis kicked in, the immediate financial pressure may have somewhat lessened, but the vulnerability to any ever so slight shock remains.[xxxix] Self-reported growth marginally recovered to around 2.5 percent in 2010-2011 and to just under three percent in 2012-2013, whereas the fiscal deficit has been pushed to the all-time low of -1.2 percent of GDP in 2013.[xl]

Structural constraints appear to solidify this low resilience to external shocks and keep the economy from a path of growth that is sufficient to maintain the high standard of Cuba's social services. Pujol calculates that in 2012, Cuba covered about 80 percent of its food needs by expensive imports, while its domestic agricultural production remains stagnant.[xli] The manufacturing sector consisting of machinery fabrication, sugar and chemical production – elsewhere a key industry for economic development and technological progress – has lost out in terms of both contribution to employment and share of GDP since 1991.[xlii] Therefore, the joint manufacturing and agricultural sectors are currently not readily available as engine of growth.[xliii] A renewed promotion of those industries would need considerable investments in input factors that must be imported, especially machinery and fuel. However, as compared to a pre-1989 level of 25 percent, gross investment has hovered around a low ten percent in the past two decades.[xliv] which does not even make up for capital depreciation.[xlv]

The Cuban economy is not only tremendously dependent on trade, it is also unusually lopsided to the service sector. Services contribute the lion's share of employment (63 percent) and value added (74 percent in 2011[xlvi]) and the social, health and education services are responsible for Cuba's extraordinarily high level of human capital.[xlvii] In general, this sector produces largely non-tradable commodities for domestic demand that possess only weak linkages to other sectors.[xlviii] Although tourism, health and education jointly provide for 66 percent of Cuba's export revenues,[xlix] they have proven unable to induce a growth stimulus into the economy. Tourism seems to have hit a limit of global demand as it continues to expand only slowly, though steadily. In turn, the revenues from health and education services that are sold abroad through humanitarian missions have been growing rapidly in the last years.[l] This convenient source of revenue, however, is by no means secure since it is highly concentrated on a few countries, notably Venezuela, who alone receives 37 percent of all Cuban exports. In the realm of imports, this dependency is even higher with 40 percent of commodities supplied by Venezuela,[li] most of which is the essential crude oil Cuba receives in exchange for highly discounted prices.[lii] Besides the uncertain political situation following Hugo Chávez' death in 2013, Venezuela's current economic turbulences '[serve] as a reminder to the Cuban government of the risks associated with interdependence'[liii] on a single source of capital.

## Economic Reforms since 2008

First, the reforms aim to significantly downsize the public sector and increase the efficiency of what remains of it. A study undertaken by the government revealed that prior to the reforms, many of the 2,600 state companies were running losses, whereas surpluses were concentrated in only a few of them. Therefore, in line with the *programme of*

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*perfeccionamiento empresarial* that Raúl Castro's military staff developed to increase the profitability of the military economy in the 90s, managers of inefficient state-owned enterprises will receive a higher level of discretion with regard to management decisions. For a pilot project running from 2013 to 2016, more than 100 firms were singled out to set their own production schedules, prices and wages. Only parts of the ensuing profit are deducted to the state budget, and the remainder can be used to create incentives for labour productivity and to undertake investments.[liv] Eventually, unproductive enterprises are planned to be shut down as they are not to be subsidised through the state budget anymore. This project is designed to target huge state companies in the nickel and oil extraction industry, in communication services, energy supply, shipping and trade.[lv]

Another, complementary scheme has been enacted since December 2012 to target industries 'that are not essential in the development of the economy.'<sup>[lvi]</sup> Current state-owned companies are to be converted into cooperatives under workers' management and private entrepreneurs are in turn encouraged to lease idle state capital and found their own cooperatives. To date, this scheme includes 222 low-technology enterprises in the agricultural, transportation and construction sector, in food production, food services and miscellaneous industries. While the capital in both cases largely remains property of the state, they will be given control over all production, price and wage decisions. Just as for the enterprises in the first scheme, profits above a certain threshold are at the disposal of the cooperative.[lvii]

At the bottom line, in 2010, the government announced those restructurings would result in laying off as many as half a million state employees until mid-2011 and ultimately 1.8 million by 2015,<sup>[lviii]</sup> which would constitute about 10 and 34 percent of the country's labour force respectively (own calculation; EIU) and relieve the state's payroll accordingly.[lix] In order to absorb the dismissed labourers, the private sector is being promoted once again. Initially issued under Fidel Castro in the 90s, the number of licenses stagnated at 150,000 in 2010, before the new reforms started to take hold.[lx] Among the 201 meticulously listed categories that are now open to self-employment are many artisanal, home repair and an overwhelming number of retail, transportation and food catering jobs.[lxi] They have been given a great degree of contract freedom. They may now hire and contract labourers, rent rooms and do business with all kinds of economic actors, including state entities. However, highly skilled professionals such as physicians, lawyers, architects and, most notably, engineers are not allowed to take up employment in their own professions outside the public sector.[lxii] A second policy package targets Cuba's shortage of foodstuffs and the inefficiency of its agricultural sector. A governmental decree issued in 2008 gives private individuals and cooperatives the right to rent unused land and sell parts of the produce (30 percent) on free farmers markets.[lxiii] The remaining 70 percent of their produce is sold to the state in exchange for fixed prices and a supply of inputs, such as fertilisers and seeds.

## The Risk of Stalling: Unemployment

If the reforms perform sluggishly, many Cubans are bound to fall into unemployment and poverty. Although the emergence of the private sector does relieve the state budget of some of its burden, its capacity to soak up dismissed workers and provide them adequate employment is limited. Unless they cater for tourists, '[m]ost of the sector [...] involves low-income people providing goods and services for other low income people'<sup>[lxiv]</sup> which results in a low effective demand for many consumer goods.[lxv] In fact, the demand for their commodities is dependent on a transfer from the more productive sectors that remain government business.[lxvi] This would indicate that the success of the reforms on the private market is tightly linked to the income growth induced by the state sector.

As a matter of fact, the number of self-employment licenses doubled to just over 330,000 between 2010 and 2011 but thereby fell short of the target. According to Vidal Alejandro and Pérez Villanueva, only 55,500 of those who entered the private sector were former state employees,<sup>[lxvii]</sup> which would suggest that the new sector largely transfers black market activities into legality instead of creating new business activity. Between 2009, before the layoffs began, and 2011, the official ONE statistics registers an increase in unemployment by 80,000, which confirms that out of 127,000 dismissed workers, as many as 63 percent ended up without legal occupation during the first year of the reforms.[lxviii] Among those who are employed, experience is mixed. Reuters reports an informal survey of questionable quality that was carried out among self-employment Cubans in 2011. It seems to indicate that depending on the industry and location, legal and illegal payments add up to a salary for most employees, which 'is

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still miserable, just less miserable [than the state salary.]<sup>[lxix]</sup> Based on these observations, we may well conclude that self-employment is already a slight improvement for economic situations of many, whereas since 2010 unemployment and insecurity have become a common experience for many Cubans entering the private economy.

A large and increasingly solidifying problem of unemployment, insecurity and poverty would definitely pose a challenge to the stability of the political order. It would create a group of people who are excluded from the benefits of the generally improving economic situation and who therefore lose confidence in both the revolutionary regime and Raúl Castro as their leading figure. Even more so, if unemployment and failure were to be associated with unequal starting positions related to financial endowment or race – discriminations that violate the Cuban sense of equal opportunities. PCC officials, especially the orthodox ones, dread such a state of affairs. As the party is the main channel to voice the dissent of the population, its authority and power over social life seems to depend in particular on the fulfillment of the revolutionary social pact.

## The Risk of Overshooting: Losing Control

In the long run, the state-controlled manufacturing sector can bring forth substantial growth if its efficiency can be increased successfully. Apart from that, immediate reform gains will accrue to a rather small group in the private sector. Firms in the transportation services, small restaurants, bed and breakfasts, handicraft- and agricultural businesses have already made some people extremely wealthy in Cuban terms, which is visible in their dominance over the consumer markets and in their private investments in housing.<sup>[lxx]</sup> Soon, this group may also include high-skilled workers in profitable state enterprises who will benefit from increased productivity and competitive wages. As a result, the private sector is emerging as an opportunity for employment and income, which is relatively independent from the benignity of public authorities which erodes the accustomed hierarchy between the paternalist state and the population that is to be taken care of. Likewise, some private enterprises might already employ large numbers of workers or will increasingly do so as the reforms continue. Although evidence on those non-governmental actors in Cuba is naturally patchy, the *Cuban Association of Artisans* is said to bargain with state authorities on behalf of the industry, which demonstrates the already beginning translation of economic power into political influence.<sup>[lxxi]</sup> Individual firms, if those modes of collective representation succeed, may likely come to dominate a local market and will represent a significant share of the labour force in a spatial area, giving them political leverage.

Indeed, during its sixth congress in 2011, the Communist Party rejected a more liberal reform guideline as it was proposed by the government and thereby insisted on measures to be taken that forestall the concentration of property and wealth in private hands.<sup>[lxxii]</sup> Accordingly, the 2010 tax act consists of a sales tax, an income tax regime, social insurance payments and a levy on the hiring of workers clearly designed to punish job creation.<sup>[lxxiii]</sup> This stiff tax scheme may result in effective tax rates well over 100 percent for some enterprises and hampers business creation and capital accumulation.<sup>[lxxiv]</sup>

For the same reasons, the freedoms granted to private actors should not easily be taken at face value. During the reform period, public authorities have continued to take away private business licenses and crack down on entrepreneurs for more or less arbitrary reasons.<sup>[lxxv]</sup> *El Cabildo*, a hugely successful Havana-based entertainment venue and probably the biggest private employer in the country, was stripped of its license in 2012 for allegations of enrichment and minor violations of business regulations.<sup>[lxxvi]</sup> According to Domínguez, one marked feature of the reforms is the:

Extraordinary uncertainty [the government creates] because it signals, at one and the same time, not only that you can now engage in this activity but also that the government can take away its authorization. Why would you invest to improve any number of economic activities under those circumstances of uncertainty?<sup>[lxxvii]</sup>

Although according to Ritter, the new and softened business regulations rely on stiff fines rather than seizure of equipment or retraction of licenses as they did before,<sup>[lxxviii]</sup> Feinberg reports that government agencies still act on the old rules.<sup>[lxxix]</sup> Raúl Castro did attempt to align their behaviour with his official policy, but actual harassment of the private sector has lessened only slightly.<sup>[lxxx]</sup>

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The flip side of these potentially powerful reform winners is the declining power of the state economy. Although the package of policies does not directly affect the conglomerate of FAR enterprises, the military sector does already have to compete for employees on a labour market that is gradually becoming more flexible. As expected incomes in the non-state economy increase, jobs in the military sector lose the relative profitability, both for the labourers who can choose to work in either sector and for the military employers who might find themselves compelled to raise wages at their own profit's expense. This process is likely to further erode the already precarious loyalty among the lower and middle ranks of the military and the security forces, an issue of which Raúl Castro seems to be well aware. For instance, *The New York Times* reports on halfway complete constructions works for a Havana-based gated FAR residential area that allegedly is reminiscent of a 'Florida condo complex'[lxxxix]. In general, to assert the loyalty of the military in the future, more of these benefits will have to be doled out, which depend on whether economic growth can be brought about.

Stakeholders of the traditional, civilian state economy are already witnessing the erosion of their economic position. Their central control over state enterprises is being dismantled in favour of managerial decentralisation in some sectors, and the intended complete abandoning of other sectors. However, the implementation of these policies is progressing slower than scheduled, too. In 2011, Raúl Castro conceded that only 127,000 employees had been dismissed, seemingly assuming responsibility for the failure.[lxxxix] The benchmark of 500,000 dismissals was then rescheduled for 2015, four years later than expected. It is not yet clear when the 1.8 million-target will be met. Similarly, Amuchastegui suggests that the agricultural reform did not progress quite as quickly as intended. Of the 2.25 million hectares of idle land in 2008, only 1.5 million had been granted for usufruct at the end of 2012.[lxxxix] Curiously, both Domínguez and Pujol[lxxxix] blame the slow implementation of the reforms not mainly on poor preparation or slack but on active delay by an opposing bureaucracy.

Furthermore, the transformation of state enterprises into either entities of autonomous management or cooperatives is to be evaluated after some unspecified time and the policy framework is to be adapted accordingly.[lxxxix] In designing these changes as a temporarily limited and sectorally confined pilot project, the leadership signals that the reforms are in principle reversible and, in doing so, reduces the risk for the economic bureaucracy. A study conducted by the University of Havana found that managers of state enterprises are rather reluctant to assume responsibility for an autonomous entity and prefer to follow central directives and the economic plan.[lxxxix] Therefore, in order to incentivise the firms to increase their efficiency, the managers need to expect to keep their profits if they are successful and to be liquidated in the case of bankruptcy. The safety brake that has been introduced to pacify the bureaucracy is fundamentally at odds with the necessary no bail-out commitment.

## Squaring the Circle: Economic Reform without Political Inclusion

Just like past periods of openness, the current reforms will remain reversible. The optimal strategy to create an environment conducive to thriving business activity would require the authorities to submit to rules that guarantee property rights and prevent state power from arbitrarily interfering with the economy. In turn, this cannot easily be secured by an exclusive political system in which the better part of the population, among which are the new entrepreneurs, have only a negligible direct influence.[lxxxix] Of course, no such political-institutional changes are currently in sight. The PCC, as part of Raúl Castro's ruling coalition, will accept their political power to be restricted neither by a binding property order nor by an effective political representation of the emerging business class. Specifically, the hardliners of the regime, with their desire for stability, certainly want to retain the power of arbitrary interference as the measure of last resort to prevent the imminent economic dynamics from spilling over into political ones.

Unable to accept a substantive restriction of their power, the leadership still has an interest in respecting the economic liberties that have been granted – it is their dominant strategy, in game theoretical terms. In an attempt to square the circle, their preferred arrangement may thus consist in respecting the property rights of the private actors without actually being committed to it. One way to do it is by gradually building the expectation, or trust, that the state in fact does not arbitrarily interfere with private business. Therefore, to settle the conflicts between a declining bureaucracy and the increasing role of the market in both state and private enterprises, the leadership has tried to pressure the bureaucratic opposition in public. As Mujal-León argues, Raúl Castro made it abundantly clear that he

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will not tolerate any deviation from his official course of action. In preparation for the party congress in 2011, the official press published:

countless articles and letters to the editor complaining about bureaucratic incompetence and obstruction. [...] When he spoke to the National Assembly [the same year], Raúl Castro indicated his patience had worn thin, warning that “all bureaucratic resistance [to the reforms] will be useless.[lxxxviii]

## Three Possible Scenarios

Based on the theoretical framework and the empirical insights that this essay has addressed thus far, it shall now evaluate three reform outcomes that appear likely to emerge. Note that the typology of pathways is akin to the one Ritter[lxxxix] proposes: first, a continuing medium-paced reform leading to a mixed economy; second, a stagnation of reform efforts brought about by an exogenous loosening of financial constraints and third, accelerated market openings that could revolutionise the winning coalition of the country. On the basis of some exogenous variables, this essay shall make a qualified prediction for a medium term such as the next five years. Five years is an ultimately arbitrary timespan, but it represents a calculable time horizon insofar as factors that are exogenous to this study introduce a considerable margin of error which is growing, as time goes by. As will be seen, among these variables are aspects such as Cuba’s international environment, the economic progress of the reforms and the succession to a post-Castro generation.

The first development path is a simple extrapolation of the gradual reforms already observable. Based on the theoretical assumption that the support for both the new leadership and regime as such are dwindling, they will continue to strengthen the private economy, urban and agricultural cooperatives. They will increase these sectors’ capacity to create adequate employment opportunities for all those released from the state sector and thereby relieve both the state budget and the trade balance. Under ideal conditions, Cuba will continue to progress towards what is reminiscent of a regular mixed economic model comprising both private and state ownership. If the rationalisation of and investment in the traditional manufacturing industry can be carried through successfully against bureaucratic opposition, the bulk of tax revenue, high-wage employment opportunities and contribution to growth will eventually accrue from the statist and military sector. By supporting the public sector’s dominant position vis-à-vis the private economy, this moderate path largely perpetuates the alliance between FAR and PCC.

Although ‘[with] more than a decade of accumulated experience, there are few technical mysteries about how to reform an economy,’[xc] the regime has in fact entered uncharted waters. The leadership has to learn how to contain the private sector in their authoritarian political order, neither crossing the point of no return that threatens to permanently alter the power structure nor crippling its dynamism too much. This process can take some time and will by no means be smooth since it entails to build both private agents’ and state authorities’ trust in the intentions of one another. As has been suggested, this iterative game must support a stable equilibrium in a setting, in which no institutional guarantees prevent the regime from exercising its arbitrary power.

To elucidate the necessary conditions underpinning that middle course, I shall now consider a path of decelerated reforms as triggered by a positive external shock. As mentioned in the introduction, one component of Raúl Castro’s strategy is to solicit for trade agreements and foreign investment in alleged oil fields in the Caribbean Sea, which could immediately reduce reform pressures. While it appears that Cuba has quite a long way to go until either private companies invest on a large scale, or Cuba regains access to normal capital markets,[xci] political alliances are in sight. Recently, *The New York Times* reported that the Russian president Vladimir Putin agreed to cancel 90 percent of Cuba’s Soviet-era debt, which may be the prologue to a substantial bilateral arrangement.[xcii] Other would-be partners are China, Brazil and, after all, Venezuela.

Either way, how such a wind-fall income affects the reform strategy depends on its magnitude and its expected time scale. If it provides for stable revenues over a predictably long period of time, such as the discovery of a major oil deposit, it can be deemed enough to build the support needed to stabilise the regime. The Cuban leadership will then swing back to a statist strategy and will choke off activities that provide a living independent from the regime. A different positive change in the external environment, such as a bilateral trade agreement with a major power, may



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provide for a source of revenue which is not certain beyond the short term. This would cause the leadership to undertake investments into the productive base of the state economy, a step which, nonetheless, relieves them of some of the pressure to restructure the public economy and to promote private business. In any case, if such a surplus income reaches the coalition, it will magnify its power over outsiders and may aggravate problems of profit-seeking and corruption.

Much more interesting is the contrasting scenario of deteriorating economic conditions relative to the middle path. As a measure of last resort, reforms will accelerate if the moderate policy fails to result in an increase in income, employment and political support. More than ever, the government would have to find a way to discipline both the economic bureaucracy and the police force to prevent them from choking off private business. If the decline is serious, they will find themselves compelled to revise the tax scheme to encourage their profit making, hiring and investment. Eventually, even the privatisation of traditional state-owned enterprises could be considered, if that is what it takes to create the necessary support for the regime.

By increasingly dismantling the power basis of the economic bureaucracy and the PCC, such a process could be carried far enough as to reach a tipping point, which may mark a qualitative change in Cuba's political economy. At this point, the leadership risks the creation of powerful economic actors in the course of a dynamic, market-driven development. Akin to the so-called Chinese way, the regime would then seek to adopt those winners into their winning coalition and to abandon the old economic elite. Eventually, Cuba may end up in the grip of a military-business alliance in which the party does not need to have much power anymore. As a matter of fact, the present policy change is only the last in eight reorientations back and forth between pragmatic reforms, policy stagnation and statist backlash since 1959. During such cycles, positive economic performance has generally paved the way for a reversal of market-oriented reforms whereas the subsequent orthodox period has again led to deteriorating economic indicators.[xciii] Therefore, without some degree of democracy, that gives a greater weight to the population's interest, only constant pressure on the regime survival is what keeps Cuba on the reform track.

Another element of uncertainty enters the discussion in as much as time is almost up for the Castro brothers and the question of potential successors is increasing in importance. Raúl Castro announced he would not run for office again after having completed his second presidential term in 2018. It is safe to assume that he is already constructing a group of successors to take his place, which will sooner or later be accompanied by a replacement of the entire revolutionary generation in both PCC and FAR. Amuchastegui estimates the share of individuals in their 40s and 50s to be above 90 percent of the top leadership already.[xciv] No matter their political stance, they will need to perform well to gain support among the population even more than the Castros. However, if Raúl Castro fails to securely establish a new leadership, factions could emerge that individually are not powerful enough to rule the country. During this struggle, resources otherwise going into the reforms might be expended on securing loyalties and buying support within the coalition even though that puts an additional strain on the regime's stability.

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