

CUBA IN TRANSITION

Issues to Watch

2018–2023

This week, Cuba begins an important transition. On April 19, 2018, Raúl Castro steps down as head of state. An as-yet unnamed successor elected by Cuba’s National Assembly—presumably First Vice President Miguel Díaz-Canel—will take his place. We do not know whether Raúl Castro will remain a member of the Council of State (the highest executive branch of the government, over which the President presides). He will continue as First Secretary of the Cuban Communist Party through 2021, separating leadership of government administration and the Party bureaucracy for the first time. But, however partial, Castro’s retirement portends the ultimate passing of the Revolution’s “founding generation” from power. Rumors that he is planning to move to Santiago de Cuba, far from the seat of national government in Havana, suggest, at the very least, a symbolic break.

What this all means has been subject to much comment and speculation. Yet, in the absence of clear information—let alone a public platform of ideas and concrete policy proposals from aspirants to Cuba’s highest leadership posts—no one has a crystal ball.

Instead, in the following pages we outline six key issues to watch as the new leadership takes office and faces a series of inherited challenges during its first term (2018-2023). Ranging from unresolved financial quandaries to renewed tensions with the United States, these dilemmas make one thing clear. With an economy on the rocks and an unfavorable external environment, Cuba will enter a new political era from a position of considerable uncertainty.

THE NEW LEADERSHIP: SPACE TO MANEUVER AND RELEASING THE BRAKES ON REFORM

Miguel Díaz-Canel is Raúl Castro’s widely presumed successor. A fifty-seven-year-old Party stalwart, he rose to the rank of First Secretary of the Cuban Communist Party in his home province of Villa Clara in 1993 before being named to the same position in the province of Holguín in 2003. Named to the Communist Party’s Politburo that same year, his quiet rise to national executive authority began in earnest. Appointed Minister of Higher Education in 2009, he went on to be named a Vice President of the Council of Ministers in 2012. Since 2013, he has held his current position, First Vice President of the Council of State, constitutionally next in line to Raúl Castro. To date, no credible alternate has emerged as a rival for the top executive job when Castro retires.

If he is confirmed as Cuba’s next head of state, Díaz-Canel will not assume office with a blank slate. From 2010 to 2016, Raúl Castro steered Cuba down a slow, but meaningful path of economic reform. State payrolls were considerably reduced; authorities expanded space for the private sector to take up the slack. Obsolete state enterprises were told to shape up or prepare to shut down. Despite being framed as compatible with “socialism,” the so-called “update of the Cuban social and economic model” represented a striking recognition that the Cuban state could no longer afford to handle virtually all economic activity on its own.

Nevertheless, as the Cuban economist Pavel Vidal recently [summarized](#), the macroeconomic results of the process ten years later are disappointing. GDP growth has proved anemic (if not entering into decline in the last two years), agricultural production did not increase (contributing to seriously distorted trade balances in food products), and the private sector—while a success story in many ways—remained hampered by the lack of an internal wholesale market and stringent regulations that limited the economic activities in which it could operate. The state sector, meanwhile, continues to be deeply inefficient, and foreign investment levels—though significant in boom sectors like tourism—have not increased enough to significantly boost overall growth. Add to this scenario the declining economic fortunes of close ally and partner Venezuela, and Cuba, despite successfully renegotiating down many of its international debts, is struggling to accrue the necessary hard currency to pay all of its import bills.

As a result, sectors from within the Cuban government and Cuban society that were suspicious of Raúl Castro’s reform agenda from the beginning have been on the offensive in the past two years. To the extent they are concerned with inequalities generated along the way, they might have a point. But a credible case can be made that the disparate economic outcomes of the reforms so far—between those who successfully leveraged opportunities in the private sector, and those who remained wedded to low wages paid by the state—owe more to the limitation of the changes implemented rather than their breadth.

Díaz-Canel will thus assume office at a time when the economic path forward seems in doubt. Recent rhetoric from officials has stressed middle-management errors and poor implementation as the culprits for lackluster economic performance. Leaders of the government are not discussing the need to rethink or deepen the overall reform plan. Despite assertions to the contrary, the original agenda of socialist “updating”—many of whose tenets remain unimplemented—appears to have yielded to counter-reform pressures. Thus, if he is to chart a path forward, Díaz-Canel will have to make a case for doing so as other voices increasingly seem inclined to turn back the clock or freeze it in place.

This task is made more difficult by the unenviable position Díaz-Canel occupies. As the first non-Castro to lead Cuba in almost six decades, and the first leader who does not hail from the founding generation of revolutionaries, Díaz-Canel will be unable to count on the automatic legitimacy that comes with “histórico” status. While his public appearances have increased, he remains a relative unknown for Cubans and foreign observers alike. He will lead a government that, while composed of one political party, is certainly not of one mind behind the scenes regarding the needed pace or shape of economic change. Moreover, with Raúl Castro leading the Cuban Communist Party through 2021, Díaz-Canel’s power may be somewhat constrained.

Do not expect Díaz-Canel to immediately surround himself with a new cast of close supporters. Nor will he articulate an agenda that sharply departs from the status quo—especially as Raúl Castro and other históricos remain peripherally on the scene. Still, observers should watch whether and how Cuba’s new leader maneuvers to secure his own legitimacy. The stakes are too high to tread water, and the unresolved economic problems that Díaz-Canel’s predecessor will soon dump on his lap represent both a liability and an opportunity to make his name.

CURRENCY UNIFICATION (AND DEVALUATION?)

The gravest economic issue Raúl Castro will pass to his successor is currency reform. For 25 years, Cuba's economy has been saddled by a vexing dual currency system originally conceived as a way to shield Cuban citizens and public welfare systems from the worst effects of the post-Soviet economic crisis. It worked for a time, but the island's two-tiered economic structure—one in CUP ("regular" Cuban pesos), the other in U.S. dollars and, later, CUC ("convertible" pesos, pegged artificially to the U.S. dollar)—has become a symbol of post-socialist inequality. CUCs are largely reserved for purchasing "higher order" goods, especially in the tourist sector, while state Cuban employees continue to be paid in CUPs. Of equal concern are the ways the system creates serious financial and accounting oddities that impede economic performance. Fixing these distortions is paramount if Cuba's economy is to be put on a path to long-term development, but this is also one of the most difficult issues the new government can take on.

The problem, in truth, is not that Cuba has two currencies. The real difficulty is that Cuba has multiple exchange rates between them. For Cuban consumers, CUPs and CUCs are freely exchangeable at a rate of 24 to 1. In most Cuban businesses—especially state-run stores—prices for goods are listed in both. (An imported bottle of cooking oil priced at 2 CUC can thus be purchased for 48 CUP, but remains expensive for a state employee earning just 650 CUP a month.) In much of the state sector, by contrast, the rate is 1 to 1. This highly overvalued exchange means that otherwise inefficient, unproductive state companies have a built-in accounting buffer and unfair advantage. This seriously distorts measurement of the companies' real performance, while at the same time impeding evaluations of their prospects to serve as partners for foreign investment. The artificially inflated exchange rate within the state sector also makes imports look cheaper than they really are. Cuba needs to do the opposite: import less and export more.

Fixing the problem is easier said than done. If the government eliminates currency supports for the state sector in one fell swoop, many state enterprises (especially those not linked to tourism or the export sector) will fail, leading to a rise in unemployment. In the absence of efforts to expand the private sector further (see #3 below), or massive subsidies that the state cannot afford, the results would be politically untenable. On the other hand, if the government continues to artificially pad the state sector's numbers via preferential exchange rates, public companies will avoid the overdue wake-up call they need. Calls from the government for the sector to "be more efficient" are naïve until officials implement this fundamental change.

A related issue concerns devaluation after the internal rates are unified and the CUC is eliminated. Most economists agree that even the “street” rate of 24 CUP to 1 CUC seriously overvalues the CUP relative to the U.S. dollar. Thus, if Cuba is to unify the internal rates and move to a CUP-only economy, a devaluation of the CUP may also be in order, or unavoidable. On the positive side, Cuban exports would look more competitive on global markets, and Cuba would become more attractive (and cheap) as a foreign investment site. But prices would immediately rise for imported food and household products in state-run stores. (70% of the food Cubans consume comes from abroad.) The results, once again, are politically sensitive.

There is still no official timeline for when and how the Cuban government will take on currency reform. But, in a February conversation, Cuban officials told a visiting U.S. congressional delegation that 2018 would be the year to do so. Rumor and worry on the island already abound. Thanks to a vibrant foreign currency black market, more affluent Cubans have been busy cashing out the CUCs they hold and exchanging them for foreign bills whose value will remain strong. Especially at a time of weak economic growth and declining trade with key allies like crisis-ridden Venezuela, the fundamentals do not appear in order for an easy monetary transition.

Cuba does not have the extensive foreign currency reserves on hand or international financial support (from institutions like the World Bank) to help a new targeted exchange rate stick. The European Union is said to be advising on the matter, but it would be far better to undertake such a significant shift under better macroeconomic circumstances. Can monetary authorities chart a middle road that avoids the pain of shock therapy, but addresses the problem sufficiently to generate real results? Tackling the issue is high-risk, but if Díaz-Canel’s government can manage this problem well, it may also earn high rewards.

PENDING SMALL BUSINESS REGULATIONS

One of the ways Cuba could mitigate the negative shock of currency reform on the state sector would be to expand opportunities for private enterprise. Yet, the Cuban state appears poised to do just the opposite. As officials have debated the disappointing results of economic reforms so far, they have singled out small businesses for criticism. Authorities insist that the post-2010 expansion of *cuentapropismo* was necessary. But lately, they have been beating a drum of steady reproach, impugning the “self-employed” for engaging in too many “excesses” and “illegalities.”

Is there petty corruption and tax evasion in the sector? Yes. But, in a cash economy with limited banking facilities—and in which most private activities are concentrated in the services sector (restaurants, bars, party planners, etc.)—expecting full tax compliance was unrealistic. While it is likewise true that the private sector relies on black and grey markets for many of its supplies, this is because the closest wholesale markets are discount stores in Miami. (Supply chain by Cuban-American suitcase, we might say.) Besides, the internal black market from which the private sector draws depends on state sector employees for its supplies. It takes two to tango.

The recent scapegoating of *cuentapropistas* may thus be a response to social and political anxieties as much as economic fundamentals. To a degree, one can understand the critics' concerns. With the expansion of small businesses, especially those catering to dollar-wielding tourists in highly trafficked cities like Havana, inequalities and class divisions have become more sharply noticeable than in the past. Especially during the boom of U.S. visitors between 2015 and 2017, the emergence of high-priced restaurants—some selling nostalgia for the pre-revolutionary 1950s in their interior design—became an easy target for socialist stalwarts and culture warriors. Meanwhile, growing commercial demand for produce in consumer markets exceeded supply, boosting prices for the Cuban working class. As alluded to above, such distortions were exacerbated by the limitations of Cuban reform efforts—for example, the failure to sufficiently free up agricultural production to respond to increasing demand. So, too, did the limitation of self-employment opportunities to 201 narrowly defined categories invite “creative” stretching of the rules, while shutting out many Cuban professionals who did not have hospitality or service-sector skills. At the same time, the failure to pursue international partnerships and microloan programs meant that successfully starting a business often meant relying on informal financing from family members abroad. Those who did not have access to such diasporic networks were out of luck.

In August 2017, the hammer dropped. Cuban authorities announced a temporary freeze on the issuance of new licenses in most legal self-employment categories pending the creation of a new regulatory framework. Eight months later, that freeze remains in place. Some of the changes that authorities have previewed are welcome—like condensing several related license categories under a broader heading, or even requiring that business owners use bank accounts. Others, like restricting licenses to one per household, will impede creative business models that bred adaptation and provided employment.

The future of the private sector in Cuba is thus another serious economic predicament that the Raúl Castro government will leave in Díaz-Canel's

hands. A purported draft of new rules, dated August 2017, has circulated informally among Cuban scholars and economists. If it is accurate, the government plans to not only raise taxes on private businesses, but also require more stringent documentation to secure licenses to operate. (This includes proof of financing, though what kind of financing will be deemed legal is unclear.) It is hard to see how such limits make sense in the absence of a clear path to reviving the state sector and increasing wages therein. Nor do the draft rules grant private businesses the “legal personality” that the Communist Party has notionally approved and that would be necessary for those businesses to access import channels directly. Recently, the government announced that it was opening a wholesale market in Havana. But only non-agricultural cooperatives—for the most part, formerly state-run restaurants and service businesses converted into a cooperative ownership structures—will be allowed to purchase supplies.

Despite these headwinds, Díaz-Canel has an opportunity to flip the script, enlisting small businesses as allies, rather than antagonists, of a broader path to reform. Such a path would involve proactively addressing equity and access issues in the sector by seeking external financing opportunities, boosting education and training, creating wholesale markets, and expanding the purview of available licenses, rather than cutting existing private employers off at the knees. The state, after all, cannot provide sufficient alternatives for well-paid employment, even in outward-facing sectors like tourism or in the Mariel trade zone. If the state were to devote a portion of tax revenues to low-interest loans for those who do not have the money to start a business, cuentapropistas themselves might even stomach higher progressive business and income tax rates. The still incipient private sector and Cuban authorities may appear on a collision course, but this is not due to physics; it is by choice.

THE TRUMP POLICY: HOLDING PATTERN, OR FURTHER ROLLBACK TO COME?

Internal suspicion toward Cuba’s private businesses has also increased because of a new external actor with the sector in its sights, at least rhetorically: the Trump administration. Indeed, in announcing his supposed “cancellation” of President Obama’s policies toward Cuba, President Trump borrowed a page from his predecessor’s argumentative playbook, announcing that new restrictions on U.S. engagement with state enterprises run by the Cuban military are intended to support private sector growth. President Obama, too, generated angst among Cuban internal hardliners when talking about the diplomatic opening as a means to support Cuba’s non-state, over its state, sector. But whereas the Obama

administration used such rhetoric in the context of an unprecedented effort to recognize Cuba's sovereignty and normalize diplomatic ties, the Trump team has now wed the premise of "private sector support" to more antagonist aims.

As the Cuba Study Group has argued before, President Trump's policy is achieving the exact opposite of its stated effects. By eliminating individual people-to-people travel, fewer U.S. citizens are visiting the island overall; no amount of diversion from military-owned hotels can make up the difference. Cuba's entrepreneurs—owners and employees of restaurants, bed and breakfasts, and all manner of related, private tourist services—have therefore faced a one-two punch of a license freeze from their own government coupled with a decline in visits from what had become their fastest growing market of consumers.

That said, if the Trump administration's Cuba policy had been limited to the tough-talk of his June speech in Miami, and the new travel regulations that came out as a result in October, one might be inclined to conclude that the approach was more bark than bite. To this day, many core pieces of the Obama policy remain in place—from freedom of Cuban-American travel to the removal of Cuba from the list of State Sponsors of Terrorism. Working groups from both governments continue to meet on issues of mutual concern (migration, law enforcement, etc.), and individual travel to Cuba actually remains possible under a different category ("Support for the Cuban people"), though many would-be travelers are unaware of this fact.

What has really damaged U.S.-Cuba relations is the steady fallout from a series of serious, but as-yet unresolved "health incidents" affecting U.S. personnel in Havana. Dating to late 2016, these incidents were publically disclosed in August 2017. In response, the State Department withdrew most U.S. staff from its embassy in Havana this September and issued a Travel Warning that scared off greater numbers of U.S. visitors, further compounding the damage to the Cuban private sector. Diplomatic tensions subsequently increased to a fever pitch as both sides blamed one another for politicizing what the United States initially labeled "sound attacks" (spuriously so, according to the FBI). Finally, in March 2018, the United States made its staff reductions at the U.S. embassy in Havana permanent. Our diplomatic presence in Havana has not been so depleted since before the establishment of a U.S. Interests Section in 1977. As Cuba approaches its most important leadership change in almost sixty years, U.S. foreign policy institutions are flying blind.

Is there any way out of this hole? In the short-term, not likely. Despite controversy over his handling of the "sound attacks" issue, Rex Tillerson was one of the Executive Branch voices that argued against a more

complete reversal of the Obama policy. Now Tillerson has resigned, and new Cabinet officials look even less favorably on a policy of engagement than those who recently departed. We also know that influential voices in Congress feel that the Trump administration's regulatory changes did not go far enough. Has the Trump administration checked the box of Cuba policy, and is it too consumed by other crises to look back? Or might new hardline members of the administration work with congressional allies to embark on round two?

This issue matters intrinsically to Cubans, of course. But it will also shape the space—or lack thereof—that Cuba's incoming leadership and civil society actors (see #6) have to advocate for further internal change. If Washington turns up the heat, we will witness more of the defensive impulses already displayed by the Cuban government in response to the Trump administration's rhetorical animosity. Actors in favor of internal counter-reform, in other words, will strengthen their hand.

MIGRATION PRESSURES

For many Cubans, the most devastating, immediate result of the U.S.-Cuba diplomatic unraveling concerns another issue all together: migration and travel. Because the U.S. embassy in Havana is operating with only a skeleton staff, its consulate is basically closed. This means that the increased pace of temporary Cuban visitors to the United States during recent years—to visit family, or participate in educational and cultural programs—has slowed to a crawl. The only way to get a visa for short-term travel is to apply at a third country's U.S. embassy. Even worse, those Cubans seeking to permanently migrate abroad—via family reunification procedures, for example—must apply for their visas at the U.S. embassy in Georgetown, Guyana. This is an improvement over the first third-country site, Bogotá, Colombia, as Cubans can travel to Guyana without a visa. But Cubans still need the money to support the costs of the trip. Not even those qualifying for refugee status—that is, victims of political persecution, who previously could apply for a visa at the U.S. embassy in Havana—have an easy way out.

These developments come on the heels of the end of the Wet-Foot-Dry-Foot policy in January 2017. In one of his last acts in office, President Obama eliminated the automatic granting of entry for undocumented Cuban migrants who make it to U.S. territory or a port of entry. This was consistent with a broad agenda of bilateral normalization, but it also represented a sharp blow for Cubans who, over decades, had come to see a legal path to entry into the United States as guaranteed.

At the same time, the United States recommitted to issuing 20,000 visas a year for legal Cuban migration to the United States. Washington first made this pledge to Havana in 1994 to stem the number of future undocumented migrants. With Wet-Foot-Dry-Foot simultaneously in place, it never worked. Fearing that the latter policy would go away, the years 2015–2017 saw the highest volume of undocumented Cuban migration to the United States in thirty years. With the closing of the consulate, however, now the path to legal migration has been foreclosed as well. If leaving the island has long represented the preferred strategy for those seeking new political and economic horizons, the “safety valve” through which generations of Cuban-Americans passed has been shut.

Depending on how long this impasse lasts, the consequences could be significant. In the short-term, the United States has already admitted that it will not be able to meet its 20,000 annual visa commitment via third-country processing. How the Cuban government responds to this violation of a bilateral accord remains to be seen. More broadly, if the consular shutdown persists throughout the remainder of the Trump administration’s first term (and perhaps into a second), one wonders whether migration pressures will increase internally on the island, and to what end.

In the best of circumstances, a slowing brain drain may prove a net plus, even if the growth of remittances (critical to the Cuban economy) decelerates. Still, in the absence of forward progress on the economic front, internal dissatisfaction may have nowhere to escape. Some may believe that shutting down Cuban migration finally creates a true “pressure cooker” scenario on the island, one that the failed trade embargo never could on its own. Still, social detachment and anomie—and wasted money traveling to third countries for visa interviews—are more likely to be the result than a political explosion. Either way, given its posture on immigration issues generally, the Trump administration is unlikely to quickly reopen the migratory gates.

CIVIL SOCIETY CLIMATE

Raúl Castro always framed his reforms—or “update”—in ways that stressed political continuity. To the extent that he has spoken in public about his own goals, Díaz-Canel has done the same. “Above all there has to be continuity,” he told reporters this November. “I do not conceive of ruptures in our country.” The subtext of such remarks was clear: when the change in leadership comes in April, the political system will remain the same; the “transition” will be one of generations, not ideas.

If Raúl Castro, too, spoke of “perfecting socialism” rather than undermining it, it is also true that his decade in power saw a significant, if delimited flourishing of public discussion about what “socialism” might mean. Outright political opposition remained proscribed. Self-identified dissidents continued to suffer short-term arrests and other forms of harassment. But, at the same time, ideas and histories that had once been taboo to discuss—the place of the market and private enterprise, the need for Constitutional reform, and greater democratic participation in decision-making—became more common political speech. This progress occurred not by fiat, but because a variety of actors in a fraught middle ground forged space to engage in robust analysis and debate. Important players included academics at public universities and institutions, religious publications, independent media outlets, and non-opposition-oriented civil society initiatives. It was in the writings and publications of such actors that the reforms the Raúl Castro government did implement—and their limits—were most seriously picked apart, egged on, and subjected to constructive critique.

If such voices earned a place as legitimate interlocutors in the national debate, the last two years have seen this middle sector come under increasing political and rhetorical attack. A coordinated campaign across the Cuban media this summer against so-called “centrism” represents only the most visible manifestation of a trend. The key junctures galvanizing this pivot seem to have been President Obama’s visit to Cuba in March 2016, followed by the death of Fidel Castro later that year. Both events carried obvious, but opposite, symbolic weight. From that point, anything sniffing of “capitalism lite” came in for greater reprimand—irrespective of the Cuban state sector’s own partnerships with global capitalist firms. *Cuentapropistas* became one target of this revanchist mood, as noted above. So did a prominent alternative “think tank,” university professors writing for non-state publications, and even street purveyors of pirated foreign media and TV.

Under Díaz-Canel, will this climate change? Not likely in the short term. A leaked video from February 2017 showed him brandishing hardliner bonafides for the military and security establishment. But, it is also worth noting that threats therein to shut down one prominent non-state media site did not materialize. For these actors at least, the mood so far is not overtly repressive so much as one of a quiet war of positions and words. Regardless, civil society actors that had positioned themselves as critical companions of Raúl Castro’s reforms feel isolated. Will this pattern continue, reflecting the insecurities of the new government as it faces a new era and the typical “siege mentality” that sets in when U.S. policy becomes more aggressive? Or can such internal Cuban actors, like the private sector, instead become allies of a reinvigorated path to reform?

CONCLUSION

No one should envy Miguel Díaz-Canel's task. He will assume office at a time of considerable economic insecurity, and some of the most pressing issues that Raúl Castro might have confronted with greater historical authority—currency reform, especially—will fall on his plate. If Raúl Castro himself struggled to marshal a stable political coalition within the government and the Party to press an agenda of reform, Díaz-Canel may face greater difficulties still. Meanwhile, Cuba's new administration will confront these challenges against the headwinds of Venezuela's crisis and the Trump administration's unpredictable hostility.

The next five years represent a crucial but uncertain juncture in Cuba's history. Critical decisions on the economic and political future of the country must be made. The world will be watching to see how the island's new leadership responds.