

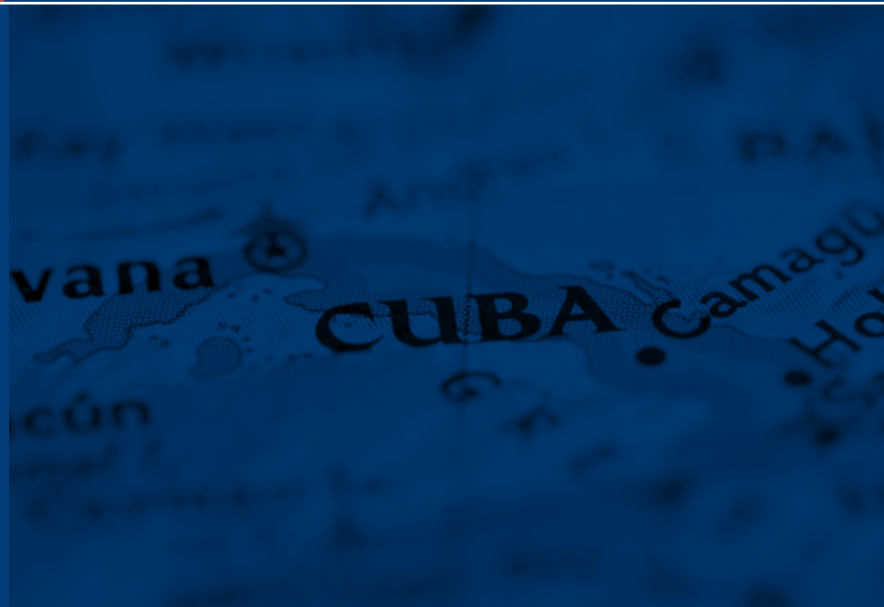


# Soft Landing in Cuba?

Emerging Entrepreneurs  
and Middle Classes

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NOVEMBER 2013



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# 1. Introduction and Summary

**W**ithin the Cuban state socialist system, a dynamic independent private sector as many as 2 million strong, and middle classes possibly majoritarian in scope, are rapidly emerging to define the new Cuba. The old narrative—that Fidel and Raúl Castro had to pass from the scene before real change could occur—has been discredited by these current trends.

The growing private sector is sopping up unemployment and providing the Cuban public and international tourists with a widening range of more attractive goods and services. A common imagery fixes Cuba as a poor society whose middle classes departed in the wake of the revolution; yet in Cuba today the middle class has been replenished, such that as in much of Latin America, Cuba has become a society of emerging middle classes (albeit with depressed levels of private consumption). These tectonic shifts are unlikely to reverse as the Cuban socialist system becomes more heterogeneous and pluralistic. But it remains to be seen whether the powerful Cuban state is prepared to allow private business and the overlapping middle classes to extend their wings and grow into medium- and eventually large-size firms, and whether state entities will seek to partner with successful private entrepreneurs, a newly experimental cooperative sector, and take advantage of foreign (including diaspora) capital. Only then might today's modest economic gains accelerate into a genuine boom.

Since the collapse of the Soviet Union, Cuban socialism has indisputably failed to generate the savings and investment required to place Cuba on a sustainable path to prosperity. The decay of the urban landscape is on display in Havana. Factories and farms, suffering from prolonged de-capitalization, are unable to supply the domestic market with sufficient goods and services to meet consumer demands and aspirations and (with some exceptions) are too inefficient to compete in international markets. Most painfully, the best educated youth are exiting the island in alarmingly high proportions. In response to economic stagnation, the government has embarked on an effort

to reform the state-owned enterprises (SOEs), but prior efforts in Cuba and frustrating experiences in Eastern Europe and elsewhere suggest the difficulty of the task. Rather, it is the emerging private sector that offers the best hope for a more dynamic and efficient Cuban economy, especially if it is permitted to partner with foreign investment and with the more efficient SOEs.

Of an active national workforce of 5.1 million, already over 1 million persons (or 20 percent) can now be classified as wholly private sector, including some 430,000 legally registered self-employed operating throughout the island. In the agricultural sector, there are some 575,000 farmers who own or lease their private plots, working individually or in service cooperatives, many of whom are prospering from the rise of market-driven agricultural markets. In addition, another 600,000 to 1 million (or more) workers can reasonably be labeled private sector. These include informal, gray area or illegal full-time businesses and another, probably even bigger, segment of the population that we shall label GESPI (government employees who earn substantial private income at least equal to their meager state wages) engaged in a plethora of creative activities. Altogether, as many as 2 million (40 percent of total employment) enterprising Cubans, and possibly more, can be counted as private sector.

In-depth conversations with two dozen pioneering entrepreneurs and informal conversations with many others around the island suggest the energy and dynamism of the emerging private sector but also reveal their frustrations and complaints regarding the inaccessible state banking system, scarcity of critical inputs and of commercial rental space, burdensome taxation, and more generally the unsettled business climate, all of which must be remedied if private initiative is to thrive and the Cuban economy to emerge from its prolonged stagnation.

Many of the small businesses will remain modest in size and ambition, but some could grow to become major generators of savings and job creation. In the specific context of Cuba's political economy, this study suggests four stages of capital accumulation during which private business can, step by step, add to household incomes, move forward to generate hefty profits, forge domestic value chains, and ultimately build alliances with efficient state-run firms and foreign partners. If the authorities establish a favorable enabling environment for business expansion, the private sector can eventually become a strong pillar in Cuba's new development strategy.

Observers are accustomed to thinking of Cuba in terms of a powerful state and a ruling communist party, lumping together the workforce as dependent state employees. However, since the collapse of the Soviet Union, Cuban society has become increasingly heterogeneous and complex. Just as analysts have recently discerned a large and growing "middle class" in Latin America and other

developing regions, it is now possible to identify emerging middle classes in Cuba. These middle classes overlap with the private sector, but as in other societies also include many public-sector employees—managers, professionals, skilled technicians—that fit the various definitions of “middle class” that will be explored in this monograph. For example, majorities of Cubans boast characteristics typically ascribed to the middle class: high educational attainment, marked female participation in the labor force and low fertility rates, and the security of home ownership and social security enrollment (but not the possession of many household consumer items).

These emerging middle classes have been raised under Cuban socialism and may still honor egalitarian values and be rightly proud of the revolution’s accomplishments in providing universal access to essential social services, but they also aspire to greater individual autonomy, economic opportunity, and material prosperity. They want to be able to travel and to explore the world—through the internet and in person. It may be overly mechanical to predict that these Cuban middle classes will demand democratic capitalism, but it is safe to assert that they will seek a Cuba that is more “normal,” more like other societies in the Caribbean basin where individuals have access to middle-class consumption patterns and have ample opportunities to realize their talents and pursue their careers independent of state control.

Whether these middle classes eventually challenge state power or accept coexistence with a strong state will depend on, among other factors, whether the state is willing to accommodate their interests, or strives to choke off opportunities—at its own peril. Will state authorities seek to exclude the emerging middle classes and independent business? Or will they cultivate a more inclusive hybrid market socialism open to the international economy, where a strong state sector both collaborates and competes with the growing private sector, and the entire island is increasingly integrated into regional Caribbean basin and global supply chains? This monograph concludes with policy recommendations for the Cuban and U.S. governments to facilitate such a soft landing for the Cuban economy.

## 2. Historical Background: The Repression and Rebirth of Private Enterprise<sup>1</sup>

In its first few years in power, the Cuban revolution defined itself by its nationalizations of foreign-owned enterprises and large domestic holdings. In March 1968, in what would become a motif of his rule (disregarding the lessons of Lenin's "new economic policies" when the Russian leader pragmatically allowed the resurgence of private property and markets), Fidel Castro launched a "revolutionary offensive" and nationalized the remaining 58,000 small businesses without meaningful compensation, leaving only some small farmers to hold private property. But then in a partial reversal in the mid-1970s, the government decided to allow some space for small-scale businesses called *cuentapropistas* (those who are self-employed, working on their own account) whose numbers rapidly rose to 46,500 by 1981. Then another period of "rectification," of retrenchment and tightening restrictions, reduced the number of self-employed to 25,000 by the end of the decade. In response to the severe economic downturn of the post-Soviet 1990s, the government again relented and small businesses quickly expanded to 138,000 by 1995 (Graph 2.1). The motif repeated: once the economy seemed to have stabilized, Fidel again railed against this re-emergence of corrupting "petty bourgeois" behavior, imposed prohibitive taxes, and narrowed the types of tolerated activities.

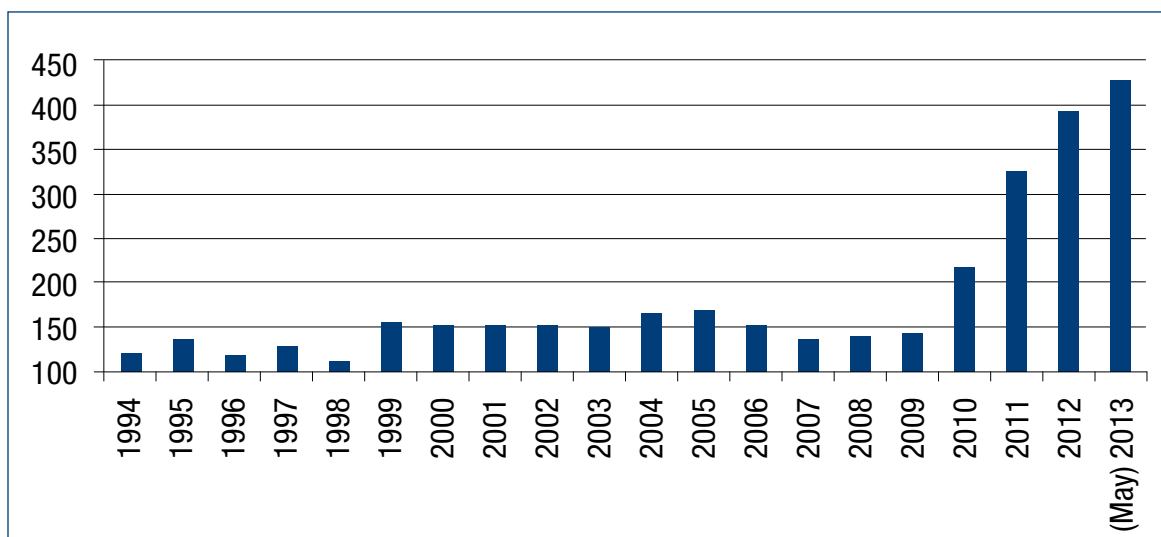
It wasn't until Fidel's younger brother, Raúl, took the helm in 2008 that the government promoted the definitive rebirth of private business in Cuba, in the context of a larger strategy to modernize the economy. The Cuban authorities hoped that an enlarged private sector would absorb

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<sup>1</sup> This section draws on a number of earlier studies on the stormy history of the private sector under Cuban socialism, including: Jorge Pérez-López, *Cuba's Second Economy: From Behind the Scenes to Center Stage* (New Brunswick, NJ: Transaction Books, 1995); Phillip Peters and Joseph Scarpaci, *Five Years of Small-Scale Capitalism in Cuba* (Alexandria, VA: Lexington Institute, 1998); Archibald Ritter, "Entrepreneurship, Microenterprise, and Public Policy in Cuba: Promotion, Containment, or Asphyxiation?," *Journal of Interamerican Studies and World Affairs*, Vol. 40, No 2, summer 1998, pp. 63-94; Carmelo Mesa-Lago, *Market, Socialist, and Mixed Economies: Comparative Policy and Performance in Chile, Cuba and Costa Rica* (Baltimore: Johns Hopkins University Press, 2000); Ted Henken, "Condemned to Informality: Cuba's Experiments with Self-Employment during the Special Period," Ph.D. Dissertation, Tulane University, 2002; Archibald Ritter, *Economic Illegalities and the Underground Economy in Cuba* (Ottawa, Ontario: FOCAL, 2006); Ileana Díaz Fernández, Héctor Pastori, y Camila Piñeiro Harnecker, "El trabajo por cuenta propia en Cuba: lecciones de la experiencia Uruguaya," *Boletín Cuatrimestral*, Centro de Estudios de la Economía Cubana (CEEC), April 2012.

redundant workers being released from a bloated public sector, soak up mounting unemployment and offer opportunities to an increasingly disillusioned youth, as well as provide more goods and services to long-suffering consumers. Memories of earlier policy reversals remain but the reform momentum is much stronger today and is occurring within an international and domestic context that makes another turn of the screw unlikely. Indeed, an impulsive effort to turn back the clock could endanger, not consolidate, regime stability. As students of revolutions are aware, upheavals often occur following periods of expansion and hopefulness, when rising aspirations are suddenly dashed by faulty or timid government policies.

**Graph 2.1. Evolution of Self-Employed, 1994-2013 (in thousands)**



Source: Saira Pons, "Emprendimiento y Reforma Tributaria en Cuba," PowerPoint presentation to the Latin American Studies Association (LASA), Washington, D.C., June 1, 2013; data for May, 2013 from *Café Fuerte* blog, June 25, 2013, <http://cafefuerte.com/cuba/economia-y-negocios/2937-cuba-429458-cuentapropistas-registrados/>. See also Oficina Nacional De Estadística (ONE), *Anuario Estadístico de Cuba*, "Workforce and Salaries," Table 7.2, various years.



### 3. A Panoramic View of the Emerging Private Sectors

Cuba today is brimming with opportunity and ambition, as the long-repressed entrepreneurial spirit is released and empowered. Urban streets—in Havana but also in Santiago de Cuba, Holguín, Cienfuegos, and smaller pueblos—are alive with new energies, as innovative restaurants open their doors, residents repair and paint their homes, and vendors hawk fresh fruits and vegetables, cheap CDs, and cell phone accessories. Change is definitely in the air, even if corporate-branded billboards and the glare of neon signs are still absent from cityscapes.

At the heart of today's private sectors in Cuba are the growing number of small-scale urban businesses (*trabajadores cuentapropistas* a.k.a. TCPs) formally registered and counted in the official statistics and which make up the heart of this study. Of the approximately 435,000 licensed TCPs, as of mid-2013, 82 percent were business owners, the remaining 18 percent being contract workers to other TCPs. In addition, many other Cubans expend their energies in activities we can also classify as non-state or private sector, participating in the still “informal” sector as public-sector employees who also labor as part-time entrepreneurs, or as temporary or migrant farm workers, independent artists, and religious workers.

In Cuba, as throughout the developing world, many small businesses prefer to remain “informal,” incentivized to remain beyond the reach of authority and taxation. In Cuba, this informal sector includes workers less visible to government inspectors, such as those re-selling second-hand clothing in their homes, repairing broken household appliances, or serving as backroom assistants in their families' bed and breakfasts and restaurants. As in informal sectors worldwide, some TCPs make this rational calculation: they prefer the risks of detection, of being caught and propositioning a bribe or simply suffering confiscation and starting over again from scratch, rather than taking the time to register, pay monthly fees and taxes, and be subject to onerous government audits. Furthermore, private businesses that do not fall within the legally authorized categories (see Section 4, page 12) have no choice but to remain extra-legal and informal.

Interestingly, in Cuba today many public-sector employees earn additional income from their private activities. Although the state does supplement wages with the provision of subsidized social services, many Cubans seek more disposable income for the purchase of life's necessities. In light of the extraordinarily low wages paid by government (median income being about \$20 per month at the official exchange rate<sup>2</sup>), this vital outside income can easily exceed official income. As one flamboyant TCP quipped to the author, "Now in Havana practically no one works for the state; and those that still do also have a private business on the side." The extra income may come from exercising their official profession, for example: ballet dancers traveling in Europe receive supplemental compensation, or fishermen who bypass a state wholesale monopoly to sell a portion of their catch on the open (extra-official) market. Some university scholars earn handsome honoraria lecturing abroad and from visiting tourists, teachers tutor privately, and official tour guides offer their services after hours. Alternatively, the extra income can come from an unrelated second job, be it fixing old cars, engaging in gray or illegal activities such as selling goods stolen from state-owned enterprises, or others, such as the case of a medical doctor who gained neighborhood fame for his fancy pastry creations. Many construction workers moonlight repairing and remodeling homes and apartments, in some cases cannibalizing materials from their day-job state employers. In the public healthcare sector, journalist and veteran Cuba watcher Marc Frank noted: "Doctors relied on patients' gifts, and sold them to survive. Nurses began caring for the better off at home, and dentists engaged in private practice in clinics after hours or in their homes, using stolen tools and supplies."<sup>3</sup> In this category, we might also include the many workers in the tourism sector, some working with foreign management companies, whose hard-currency tips well exceed their salaries paid in Cuban pesos.<sup>4</sup>

Taken together, let us call those engaged in such varied activities when the moonlighting income exceeds the official salary, "government employees with significant private income" or GESPI. In more market-oriented economies, many of these persons would be working full-time in the informal, private sector economy, but in Cuba, where the government has pursued policies of full employment, they are allowed low-productivity jobs in the public-sector, are paid accordingly, and hence seek supplemental income elsewhere.

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<sup>2</sup> Oficina Nacional Estadística (ONE), *Anuario Estadístico de Cuba*, "Salario Medio en Cifras: Cuba 2012," May, 2013. Cuba has two currencies: the Cuban convertible peso (CUC) and the Cuban peso (CUP) generally referred to as the national currency in which wages are paid. The official exchange rates are 1 U.S. dollar to 1 CUC, and 1 U.S. dollar to 24 CUP.

<sup>3</sup> Marc Frank, *Cuban Revelations: Behind the Scenes*, forthcoming from University Press of Florida.

<sup>4</sup> For an earlier listing of informal activities, see Archibald Ritter, *Economic Illegalities and the Underground Economy in Cuba* (Ottawa, Ontario: FOCAL, 2006).

## Estimating the Totality of Private Activities

According to official statistics, 1 million Cubans already work in the private sector, accounting for about 20 percent of the employed workforce of 5.0 million (Table 3.1).<sup>5</sup> These numbers capture the burgeoning army of registered TCPs as well as farmers that own or lease in usufruct their plots, including those associated in service and credit cooperatives (CCS), to which we add estimates of employees working in international joint ventures and in the newly created urban cooperatives.

**Table 3.1. The Cuban Private Sector, 2013 (in thousands)**

Private Sector Employment		Other private activities (est.)	
Registered self-employment (TCPs)	430	Self-employed (full time, unregistered)	180
Service and Credit Cooperatives (CCS)	353	Self-employed (part time, GESPI)	400-800
Land lease farmers	172	Independent artists	?
Private farmers	50	Migrant farm workers	?
Joint venture employees	34	Religious workers	?
New Urban Cooperatives	3	<b>Subtotal:</b>	<b>600 – 1000+</b>
<b>Subtotal:</b>	<b>1042</b>		
<b>TOTAL: 1,600 – 2,000</b>			

Source: Oficina Nacional Estadística (ONE), *Anuario Estadístico de Cuba*, "Workforce and Salaries," Table 7.2; Armando Nova, "Cuba's Agricultural Transformation," unpublished PowerPoint presentation, Center for the Study of the Cuban Economy (CEEC), May, 2013; Camila Piñeiro Harnecker, "Cuban Cooperatives: Current Situation and Prospects," Latin American Studies Association (LASA), Washington, D.C., spring, 2013; Mayra Espina Prieto and Viviana Togores González, "Structural Change and Routes of Social Mobility in Today's Cuba: Patterns, Profiles, and Subjectivities," in Jorge Domínguez et al, *Cuban Economic and Social Development: Policy Reforms and Challenges in the 21st Century* (Cambridge: Harvard University Press, 2012); *Café Fuerte* blog, "Cuba has 429,458 self-employed registered," June 25, 2013, op.cit.; author's own estimates as elaborated in the text.

In the absence of official statistics or adequate private surveys, it is hazardous to estimate the numbers of "other private activities," but we shall persevere, drawing on available data and conversations with knowledgeable Cuban scholars. To begin, a study published by the United Nations in 2000 estimated that the informal non-registered sector could reach 25 percent or more of the labor force, only a minor portion of which would have been legalized in recent years.<sup>6</sup> According to official figures (2011), 1.79 million Cubans of working age are not employed (the registered unemployed stood at 164,000 and another 1.628 million citizens of working age are not in the labor market, neither officially unemployed nor employed), and it is reasonable to assume that many of

<sup>5</sup> For official numbers on "private sector employment," defined to include TCPs, CCSs, and private farmers, see ONE, *Anuario Estadístico de Cuba* 2011, Workforce and Salaries, Table 7.2, "Workers employed in economic activities according to the statistics on employment," available at [www.one.cu](http://www.one.cu). Properly excluded are the Unidades Básicas de Producción Cooperativa (UBPC) and Cooperativas de Producción Agropecuaria (CPA) which have characteristics of state-owned firms.

<sup>6</sup> The study estimated the number of self-employed at 30 percent or more of the labor force, of which 5 percent were legally registered at the time. Archibald Ritter, "The tax regime for micro-enterprises in Cuba," *CEPAL Review* 71 (Santiago: United Nations, 2000), pp.139-155.

these survive through informal economic exchange (without reference to remittances sent from family and friends living abroad). Let's estimate that just 10 percent of these "idle" persons work informally, or roughly 180,000 persons (considerably less than the incidence of informality estimated in the 2000 UN study).<sup>7</sup>

For reasons noted earlier, our GESPI category is also very large. Unfortunately, as a leading authority on the "underground" economy in Cuba, Archibald Ritter has remarked there has been surprisingly little written on the subject and within Cuba there appears to be no academic analysis of the problem. Ritter himself concluded that their scale appears to be "enormous," and writes that "it is unlikely that many people could survive on their peso incomes alone without additional sources of income," even as he does not venture a more precise estimate.<sup>8</sup> Here, the number of GESPI is conservatively estimated at 10-20 percent of the public-sector workforce, or 400,000 to 800,000 persons.<sup>9</sup>

Further, let us consider several other categories of private sector labor: artists, temporary or migrant farm workers, and religious workers.

Cuba is remarkably rich in artistic talent. Thousands of professional dancers of ballet and salsa, singers and actors, painters and writers, legitimately earn income as "independent artists" when they market their products on the domestic market or overseas (although many open foreign bank accounts and fail to fully declare their earnings). As Cuba becomes more integrated into regional and global markets, many more Cuban artists will successfully monetize their talents.

The number of migrant or temporary farm workers will vary seasonally, peaking at visibly significant levels, even as knowledgeable Cuban economists report the regrettable absence of official numbers or surveys. Those agricultural workers hired by private farms, including privately-owned units as well as service cooperatives (CCS) whose members retain ownership of their land, are engaging in private-private contracts.

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<sup>7</sup> The official unemployment rate in 2011 was 3.2 percent. Oficina Nacional Estadística (ONE), *Anuario Estadístico de Cuba 2011*, Workforce and Salaries, Table 7.1, "economically active population," (Havana, 2012). Lack of data inhibits more formal estimation of the informal sector, for example as undertaken in Guillermo Vuletin, *Measuring the Informal Economy in Latin America and the Caribbean*, International Monetary Fund Working Paper, WP/08/102 (Washington, D.C.: IMF, 2008).

<sup>8</sup> Archibald Ritter, *Economic Illegalities and the Underground Economy in Cuba* (Ottawa, Ontario: FOCAL, 2006), pp.7, 16.

<sup>9</sup> According to a recent poll by the International Republican Institute (IRI) with sample size of 688 Cuban adults over the age of 18, 15 percent of the respondents placed themselves in the "informal economy—illicit/black market," which would be 1,343,000 persons, up from 6 percent just a year earlier. If the survey's precision is in doubt, the findings do confirm that many Cubans continue to work privately without official authorization. Moreover, the survey lacked a category to capture those who both work in the public sector and hold a second, private sector occupation (our GESPI). IRI, "Cuban Public Opinion Survey, January 20 - February 20, 2013," available at: <http://www.iri.org/sites/default/files/2013%20May%2024%20Survey%20of%20Cuban%20Public%20Opinion,%20January%2020-February%2020,%202013%20-%20English%20version.pdf>.

Another interesting category of private-sector employment is religious workers. The Catholic Church is gradually re-awakening and Protestant churches are being renovated (often with external funding), their melodious songs resonating from their weekend assemblies. The more private Afro-Cuban practices of Santería are extremely popular and support a large supply chain of artisans who produce religious artifacts (who may register as TCPs) and the animal husbandry that feed the obligatory sacrifices. The Santería priests or *babalú* earn monetary and in-kind compensations that surely exceed whatever they might earn in those cases where they also hold public-sector jobs. The aggregate number of religious workers in Cuba is not known, but it is not trivial.

In the future, the non-state sector will likely expand to include many small- and medium-sized private cooperatives producing both goods and services. Recently the government (at the level of Council of Ministers) approved 271 cooperatives (concentrated among formerly state-run produce markets and in building construction, but also in hospitality and transportation) in three tranches.<sup>10</sup> The number of workers or co-owners in these cooperatives is not publically available, but one knowledgeable scholar's estimate of 10 members per cooperative would place the total at roughly 3,000, with expectations of sharp increases in the number of cooperatives in the years ahead.<sup>11</sup> Co-ops will likely emerge from spin-offs of units of state-owned enterprises, from initiatives of municipalities to provide services such as child care or recycling, or from the decision of TCPs to formally join forces in a single business unit.<sup>12</sup>

Cumulatively, workers in "other private activities" add 600,000 to 1 million plus workers or another 5-10 percent of the workforce, stretching current private sector employment to 1.6 million to 2 million workers, or up to 40 percent of total employment—a much more potent force than commonly recognized.

Cuban officials have announced that by 2015 the officially recognized non-state sector will account for 35 percent of employment.<sup>13</sup> In making this projection, it is not entirely clear what base number

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<sup>10</sup> Camila Piñeiro Harnecker, LASA 2013, op.cit. See also Marc Frank, "Cuba's non-farm co-ops debut this week amid move toward markets," *Reuters*, June 30, 2013; and "Continúa avanzando actualización del modelo económico cubano," *Granma*, September 24, 2013. (*Granma* is the official publication of the Cuban Communist Party).

<sup>11</sup> One newly formed cooperative in Villa Clara province specializing in commercializing tropical birds has as many as 170 members. See Cristina Mendiando, subdirector of economy and planning, Villa Clara province, "Retos y Perspectivas del Desarrollo Territorial Local en Villa Clara," PowerPoint Presentation, Jibacoa, Mayabeque, September 16, 2013.

<sup>12</sup> Camila Piñeiro Harnecker, op.cit. See also Camila Piñeiro Harnecker (ed.), *Cooperatives and Socialism: The View from Cuba* (New York: Palgrave Macmillan, 2013), especially her introduction, pp. 1-45.

<sup>13</sup> Marino Murillo on a speech in November, 2010, as cited in Marc Frank, *Cuban Revelations: Behind the Scenes in Havana*, forthcoming. Marino noted that private sector workers numbered 600,000 in 2009, which roughly aligns with the published ONE data, in its *Anuario Estadístico de Cuba*, Table 7.2, showing 591,000 private workers in 2009 and 929,000 in 2011. Separately, Communist Party leader Esteban Lazo announced in April 2012 that within 5 years private sector production (as opposed to employment) will grow to 40-45 percent of GNP, as cited in Philip Peters, *A Viewer's Guide to Cuba's Economic Reform* (Arlington: Lexington Institute, 2012), p. 8.

the government is using, as statistics published by the National Statistical Office (ONE) fixed private sector employment in 2011 at just under 20 percent of total employment, while the Ministry of Economy and Planning suggested the significantly higher 25 percent.<sup>14</sup> The 35 percent target for 2015—which would grow the private sector workforce by 1 to 1.5 million depending upon the base estimate for today’s private sector—would seem to rest on various assumptions: further significant reductions in public sector employment (as earlier announced by Raúl Castro), formalization of some still-hidden informal workers, and the absorption of the anticipated expansion of the labor force into the growing private sector.

Reaching the 35 percent target—growing the private workforce each year by 3 to 5 percent of total employment—would also seem to imply further enlargement of private sector farming, private urban employment that expands beyond basic services into professional services and manufacturing, and tolerance of a new institution: medium-size private firms (including cooperatives). And if the government follows through on liberalizing the foreign investment regime, employment could also rise in joint ventures (although joint ventures are not included in the official count of private sector employers). Thus, under these various assumptions, the 35 percent target, while ambitious, seems feasible although it may take some time to attain beyond 2015. Including GESPI would more fully capture the extent of private activity, although would not match the government’s goal of public sector employment reduction. If GESPI and other private sector activities are included, by 2015 or so total private sector employment could reach 45 to 50 percent of the active labor force—and be growing.

But if the private sector is to expand and become an efficient engine of growth, the government will have to address the problems enumerated in the next section, as identified by today’s pioneering TCPs.

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<sup>14</sup> Oficina Nacional Estadística (ONE), *Anuario Estadístico de Cuba 2011*, Workforce and Salaries, Table 7.2. Pinero, “Cuban Cooperatives: Current Situation and Prospects,” presentation to the Latin American Studies Association (LASA), May 2013, slide 11, citing Alfredo Jam, the Ministry of Economy and Planning, February, 2011.

## 4. Entrepreneurship in Cuba Today

In 2010, the government authorized private enterprise in 181 designated activities (and expanded in September 2013 to 201 designated activities). For tax purposes, the authorities have divided these activities into seven groups and a category benefiting from a simplified tax regime.<sup>15</sup> Some of the listed occupations, such as “artisan” or light manufacture handicrafts, are very broad while others are comically bureaucratic in their specificity, such as “Benny Moré dance couple.” These

**Table 4.1. Authorized Private Enterprise**

	<b>Group Description</b>	<b>Examples of Designated Activities</b>
Group 1	The production and sale of food and beverages	Restaurants (paladares) up to 50 seats, snack shops (cafeterías), and home delivery
Group 2	The production and sale of artisan and industrial products	Artisan crafts, pottery, religious articles including animals for religious purposes, shoes
Group 3	Personal and technical services	Repair of electrical and mechanical equipment, beauty salons, animal grooming, clothing rentals, event planners, photography
Group 4	Room rentals	Bed and breakfasts
Group 5	Construction and remodeling	Bricklayers, carpenters, electricians, plumbers
Group 6	Transportation of persons and materials	Includes trucks, boats and animal transport
Group 7	Other activities	Music and other arts teachers, sports instructors, computer programming, flower sales, clowns and magicians
“Simple Activities”	A category that benefits from a simplified tax regime	Repairing musician instruments, produce street vendors, care of seniors and the disabled, parking attendants, driving instructors, gardeners, masseurs, messengers, sales of household appliances, translators, accountants, and repair of time pieces

<sup>15</sup> *Gaceta Oficial*, No. 3, Special Edition, Resolution 21/2013, January 29, 2013. The expanded list of authorized activities appears in *Gaceta Oficial*, No. 027, Special Edition, September 26, 2013.

subdivisions, with a partial list of specific designations, are outlined in Table 4.1. (For a full listing of approved activities, see Annex on page 54.)

So far, the most popular choices are restaurants and snack shops, followed by bed and breakfasts, transportation (taxis and trucks), construction, street vendors of agricultural products, music sales (CDs), recycling, and repair of household appliances (this last one a popular category probably because it benefits from the less burdensome tax regime).<sup>16</sup> Enterprising Cubans are exploiting these opportunities with a growing variety of services and beginning to expand into small-scale production. Municipal authorities are empowered to grant the licenses in most cases, which are generally approved within a week or so. Authorities have incentives to act expeditiously: approved licenses are an immediate source of fiscal revenue and create employment and services for the local community.

To encourage Cubans to enter the private sector, the 2010 regulations and subsequent official announcements removed restrictive clauses that had previously governed private sector activities and added numerous incentives:<sup>17</sup>

- Government entities including state-owned enterprises can engage in commercial exchanges with TCPs.
- Some categories of TCPs can hire an unlimited number of employees (and not just family members as had previously been the case).
- TCPs are eligible to enroll for social security benefits.
- TCPs are also allowed access to bank financing and accounts and to renting government or third-party premises (as opposed to just operating out of one's home).
- Restaurant seating capacity was augmented from 12 to 20, and now to 50, and the rental of an entire home is now permitted.
- Importantly, public-sector employees are also allowed to work in the private sector, legalizing the GESPI practice.

These reforms have opened exciting opportunities for aspiring entrepreneurs. Yet, not all of these promises have fully materialized and important restrictions remain.

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<sup>16</sup> Omar Everlenny Pérez Villanueva, "La actualización del modelo económico cubano," PowerPoint presentation, 2011, based on official sources. See also *Latin American Herald Tribune*, "Over 430,000 Cubans Work in Private Sector, Official Report Says," August 17, 2013, citing figures from the Ministry of Labor and Social Security.

<sup>17</sup> *Gaceta Oficial*, No. 12, Special Edition, October 8, 2010. See also *Gaceta Oficial*, No. 029, Special Edition, Resolution 298/2011, September, 2011; *Gaceta Oficial*, No. 053, Law 113, November 2012; *Gaceta Oficial*, No. 3, Special Edition, Resolution 21/2013, January, 2013. Also, Pavel Vidal Alejandro y Omar Everlenny Pérez Villanueva, "Apertura al cuentapropismo, una pieza clave del ajuste estructural," in P. Vidal y O. E. Pérez (eds.), *Miradas a la economía cuba: El proceso de actualización* (Havana: Editorial Caminos, 2012), pp. 41-52; and Juan Triana, *From the submerged economy to micro-enterprise: are there any guarantees for the future?* (Miami: Cuba Study Group, 2012), available at: [www.fromtheisland.org](http://www.fromtheisland.org).



## Conversations with Entrepreneurs

To ascertain the impact of these new rules of the game, the author and his then-graduate student assistant, Collin Laverty, conducted in-depth conversations with 25 entrepreneurs and informal conversations (“participant observations”) with many more Cubans working in a wide range of activities in Havana and Cienfuegos (population 145,000): restaurants and cafeterias, bed and breakfast establishments, entertainment and personal services, retail trade, construction, and transportation. These conversations were conducted between March 2012 and April 2013, lasting at least 30 minutes and often much longer. Although semi-unstructured and open-ended to allow the *trabajadores cuentapropistas* (TCPs) to express their views without excessive prompting by questions that might color their responses, the conversations did emphasize financial questions, the results of which appear in Table 4.2. We sought to establish some rapport with the respondents and eliminated cases where we felt that the respondents were being very evasive or dishonest. While this sample is too small for robust statistical tests, the conversations did reveal experiences and perceptions that generally accord with other findings, including an important research article published by leading Cuban scholars based upon recent interviews with 73 TCPs.<sup>18</sup>

**Table 4.2. Sample of Cuban Entrepreneurs: Quick Financial Facts**

Industry	Number of entrepreneurs	Average time open (years)	Average number employees	Average starting capital (USD, in thousands)	Domestic capital (number of respondents)	Overseas capital (number of respondents)
Entertainment and Personal Services	6	4.5	3	7.75	3	2
Retail	4	0.7	1	7.13	3	1
Construction	1	11	2	na	1	1
Bed and breakfast (B&B)	4	3.4	0.75	36.4	2	3
Transportation	4	2.9	0	21.9	4	3
Restaurants/snack shops	6	1.7	6.3	8.2	4	3

Source: Author conversations with self-employed in Havana and Cienfuegos, March 2012-April 2013.

From our 25 cases, the average start-up capital varies from about \$7,000 in retail to the more substantial \$36,000 in bed and breakfasts where investment was required to remodel homes. These sums are larger than the tiny “micro” enterprises frequently encountered around Latin America, where start-up funds might amount to just a few hundred dollars;<sup>19</sup> rather, these Cuban firms fall

<sup>18</sup> Ileana Díaz Fernández, Héctor Pastori, y Camila Piñeiro Harnecker, op.cit.

<sup>19</sup> A survey of 850 small neighborhood convenience stores found initial start-up costs of nearly one-half of Nicaraguan stores and one-quarter of El Salvadoran stores to be under \$100. Michael J. Pisani, “A Study of Small Neighborhood Tienditas in Central America,” *Latin American Research Review*, Vol. 47, Special Issue, 2012, pp. 116-138.

within the “small to medium” size category. Interestingly, slightly more than half—13 of 25 firms—had benefited from capital injected by overseas relatives, friends, and in one case, an investor. Many of these same firms also drew on domestic sources of capital, including personal or family savings, and from the sale of assets (homes, cars). Not one of the 25 had accessed commercial bank loans, the entrepreneurs expressing dislike or distrust of the national financial system.

The illustrative conversations (conducted “on the record”) that follow convey the exuberance of today’s pioneering entrepreneurs as well as their many vexations (also, see page 25 for “frustrated ambitions”). The conversations concluded by asking the entrepreneurs what changes they would most like to see in government policy, and their responses are also summarized here.

### Paladares and Cafeterías (Snack Shops)

The cityscape of Havana is being transformed by the blossoming of privately-owned, high-end restaurants or paladares, by one estimate numbering 400 and growing.<sup>20</sup> Family-owned restaurants typically operating within people’s homes, paladares first appeared during the post-Soviet crisis of the 1990s when the government allowed some private businesses to open, and have flourished with the post-2010 reforms, growing in scale and sophistication. Much more than eating places, many paladares are creative imaginings of Cuba’s history and culture: interpreting Cuban memories in a romantic garret (La Guarida), displaying the Cuban penchant for nostalgia for lost innocence and beauty (Bella Havana, Mama Inés, Tranvía in Cienfuegos), advertising avant garde arts (Atelier, La Guarida) and late 20th century minimalist sophistication (Le Chansonnier), publicizing the bohemian and cinematic (Café Madrigal, named after a Cuban movie), the invitingly familial (Doña Eutimia), and participation in plush elegance (StarBien). Cuban paladares are expressions of the wide range of middle class sensibilities found in today’s Cuba (see Figure 4.2, page 17).

A picturesque city on the island’s south coast and the gateway to the colonial town of Trinidad, Cienfuegos is a tourist destination that also boasts a budding of paladares, including one large investment, Tranvía. A conversation with the owner of a medium-size paladar in Cienfuegos, Las Mamparas, follows.

Opened in September 2011, Las Mamparas—a reference to the restaurant’s inlaid wooden panels—is a family business operated within a spacious home propitiously located on Cienfuegos’s beautiful, tree-lined main thoroughfare. For many years, Ms. Meylin Hernandez rented out rooms in

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<sup>20</sup> Frank, op.cit. For a review of some of the best known paladares, see Victoria Burnett, “In Havana, Family-Run Dining Goes Upscale,” *New York Times*, March 16, 2012.

another family home, and profits from that business were invested in this paladar, which is in the home of her husband. (Until recently, there was a very restricted market for residential properties and so homes tended to remain within families over the generations.) Her husband had experience working as a cook in Spain. (While not stated in this case, other restaurateurs have used savings from their overseas experiences as investment capital to open paladares in Cuba.) Seating 42 guests, Las Mamparas has a slightly bohemian décor, making it a favorite for the many performing artists that visit Cienfuegos. The interior remodeling and

FIGURE 4.1. PALADAR LAS MAMPARAS  
OWNER AND DAUGHTER



tables were crafted by hand by Ms. Hernandez's husband and daughter, Claudia, who also works the front of the restaurant. So the initial investment is a combination of family savings from another business (diversification), an existing family asset (the well-located home), and sweat equity (the remodeling). Such multiple sources of start-up capital are common among paladar businesses, while the more luxurious ventures may also benefit from a capital infusion from family overseas.

Las Mamparas employs five workers which Ms. Hernandez, poised and self-confident, personally trains. Some guests are her personal friends, but she reports—typically of the high-end paladares—that 90 percent are tourists and she must cater to the foreigners' tastes: "Cubans don't like the cooking here—they prefer more lard and fat."

As the business approaches the official 50-seat limit, Ms. Hernandez is thinking about opening a *cafetería* (snack bar or diner) under a separate license. But she has no interest in borrowing from a commercial bank, even though she understands that the collateral requirements have been relaxed: "Bank loan procedures are very burdensome and they keep you waiting for two hours or more." She had a bad experience with an investment partnership in the past, and the absence of legal contracts means that such partnerships must be based entirely on trust. She prefers to go it alone and to expand gradually; "If it goes well, I benefit, if it fails, I fail." In the worst case, she will be left with a much improved residence.

FIGURE 4.2. PALADARES: (FROM TOP) TRANVÍA, DOÑA NORA, LAS MAMPARAS, LOS COMPADRES



When asked what changes in public policy would assist her business, Ms. Hernandez replied that access to wholesale markets would lower her costs. Her kitchen also badly needs professional-quality cooking appliances which are not easy to come by in Cuba.

In contrast, Café Madrigal, a popular tapas bar in Havana, caters to Cubans as well as foreigners. A well-known film director, owner Rafael Rosales, offers moderate prices, soft classical music, and artistic wall hangings laden with historic references to draw an older, relaxed crowd. To explain his business model, Rosales offered this analysis: "I was among the first to recognize that the freeing up of economic forces is growing the middle class. My very first weekend, I watched actors, screen writers, business owners, tour guides, the families of employees in joint ventures, and many other Cubans with money in their pockets flock to the café."

### Margalyfica Catering Company

A whirlwind of energy, Margaly Rodriguez gained experience and contacts cooking at diplomatic missions in Havana, which gradually morphed into an informal catering business, Margalyfica, serving primarily the expatriate community. In June 2011, she obtained a TCP license and her business has grown exponentially: Margaly now employs three workers, recently purchased a car to help transport her culinary creations, and has found space to relocate her business outside of her home.

With her TCP license in hand, Margaly is able to contract with Palco, the large SOE responsible for organizing many international conferences and which pays her directly via official checks, and is willing to rent her catering equipment, including silverware and hot boxes. In a recent week, Margaly had catered several meals and receptions at joint ventures and embassies and served appetizers for a reception of 250 people at the residence of the Ambassador of the European Union.

Margaly candidly reports that in the catering business, it's common to underreport earnings to reduce the tax burden. She notes that harassment by government inspectors has subsided considerably. A big problem continues to be procurement, and her workers must exhaust themselves looking for ingredients. To accelerate her expansion, Margaly plans on branding her firm with new uniforms for the workers and a company website to be operated off the island by friends living abroad.

## Bed & Breakfasts: Composite Case

Bed and breakfasts—generally rentals within a home or apartment although increasingly in independent units—have become big business in Cuba. In Old Havana alone, some 400 bed and breakfast establishments provide as many rooms (600) as do the historic district's hotels. The Obama administration's 2009 relaxation of travel restrictions has resulted in a surge of U.S. visitors, and tourism from other countries has been rising as well, while new hotel construction in urban areas has failed to keep pace. Moreover, many tourists prefer the coziness of family homes, and B&B prices of some \$20 to \$50 per night are very competitive. Tourism is central to Cuba's economy and bed and breakfasts are central to Cuban tourism (even though, apparently, official statistics fail to take into account the private B&B business in reporting tourism receipts). Here is a bed and breakfast experience based on a composite of several conversations in Havana and Cienfuegos.

Previously, the García family had rented rooms in their home located on the outskirts of town in local currency. With the sale of that home, their savings from rentals, and investment from a former Canadian boarder, the Garcías purchased a more centrally located and larger home and remodeled two rooms, with the purpose to charge rent in hard-currency Cuban convertible pesos (CUCs), primarily to foreign tourists. They also fixed up an interior patio for serving meals to renters and other tourists, purchasing attractive furniture made from recycled aluminum from a private local manufacturer. They plan to reinvest profits into adding another floor, making use of construction workers that are not registered as TCPs. They do not want to approach banks, because, they believe, debtors are prohibited from traveling. Moreover, they have had problems with the authorities in the past, having been accused of renting to a prostitute—extortion, they assert—and prefer to keep their independence and privacy. Their employees are all family members except for a cleaning lady, who is not registered as a TCP, although they may register her in the future so that she can become eligible for social security.

The Garcías would like the U.S. government to facilitate access to tourist visas for Cubans so that they could travel to Miami to purchase supplies, such as a filter for a planned swimming pool, an electric fly zapper, and a pump for their water system. They also hope that the large state tourism companies will begin to book their clients directly with private B&Bs (as they have begun to do with paladares), and that telephone and internet connections will improve.

### Professional Services: Accountancy

Youthful-looking for his 51 years, Mariano had a career working for the Ministry of Finance and Prices, and brings this knowledge of the tax and regulatory environment, as well as his government connections, to his private accountancy practice, now two years old.<sup>21</sup> He works out of his home, and the small initial capital he needed to set up his office came from interest-free loans from his friends, which he has entirely repaid. All of his 40-plus clients are also small businesses, primarily from among Cienfuegos's B&Bs and paladares; indirectly, his business is heavily dependent upon the tourist trade. His prices are "negotiated," not set by the government but by private agreement. Mariano reports making a much better income than he did as a public sector employee, even as he still does not own a computer.

The main constraint on his business, Mariano believes, is the size of the private sector in Cienfuegos, which in turn is limited by the sluggish economy and low consumer purchasing power. More tourists would definitely help. Mariano works on his own, although he has a network of other accountants he can call upon for specialized knowledge, and he may join with some of them to form a cooperative as the new regulations governing cooperatives become clearer.

### Retail Sales: Piscalabis

Making good use of her personal relationship with Eusebio Leal, the powerful director of the Old Havana district, Claudia, 24, and two friends are participating in a handful of "pilot" projects whereby TCPs are being allowed to rent state property in prime tourist locations to open retail shops. Her gift shop, Piscalabis (the old Spanish word for delicate snacks), sells the works of eight Cuban handicraft makers that the shop has commissioned based on the partners' own designs, and are sold at a 30 percent mark-up over the price paid to the artisans. The artisan crafts, and the store's interior design and furniture, are entirely "made-in-Cuba with Cuban ideas," Claudia proudly asserts, but some 75 percent of the sales are to tourists, "because most Cubans can't afford it."

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<sup>21</sup> Tax laws explicitly require conformance with the accounting system as established by the Ministry of Finance and Prices, for TCPs with annual revenues over 100,000 pesos (\$4,000). *Gaceta Oficial*, No. 053, Law 113, Article 58, November 21, 2012.

To prepare the retail space, the three TCP partners invested 10,000 CUC in equal shares. Claudia saved earnings from waitressing for several years at a prominent paladar while her associates (a designer and an architect) have worked on home remodeling. University graduates with some experience in private enterprise, they have written up a formal business plan that estimates recouping their initial investment in two to three years. Their business plan projects

FIGURE 4.3. CLAUDIA, OWNER OF PISCOLABIS, OLD HAVANA



expansions into other product lines and locations, including one designed to be accessible to all Cubans. So far business has been modest but they are on course to meeting their financial goals. They could make good use of more capital but banks are “complicated” and decision making is sufficiently stressful among the three colleagues without adding more equity partners.

Among the impediments Piscalabis confronts are this capital scarcity and a tax system that quickly slaps a 50 percent tax on profits while not allowing deductions for certain costs such as publicity, even as their early publicity has been limited to emails, fliers, and word-of-mouth. A big problem, Claudia says, is that her shop is not yet equipped to accept credit cards, and U.S. shoppers are unable to make use of their credit cards in Cuba due to U.S. government sanctions. Tourists that otherwise would make purchases leave empty-handed.

To assist the three partners, the gift shop has two employees with salaries from 60-80 CUC per month plus employer payment of social security premiums. When Piscalabis opens an outdoor café on the sidewalk in front of the shop, they will hire waitresses. As the regulations for cooperatives are clarified, Piscalabis may convert to that legal designation.

### **Building Construction and Home Remodeling: An Independent Entrepreneur and a New Cooperative**

The greater availability of construction materials combined with the sudden legalization of home sales—adding dramatically to the evaluation of family assets—has produced a boom in home remodeling in Cuba. The deteriorated Cuban housing stock is very badly in need of repair and expansion, and the opportunities for private construction firms are ample.

FIGURE 4.4. JESUS, BUILDER



Jesus, 53 years old, has been working as a TCP since the early 1990s. He employs two family members under his TCP license, and draws on a wider network of construction workers as specific jobs require. He reports that friends and family—he has a brother working construction in Los Angeles, California—have brought him tools, “As gifts, that’s the Cuban way.” For construction materials he does not use bank credit, rather he prefers for his customers to pay such costs in advance. Almost always, his clients are paying for his services from funds they have received from relatives living abroad.

Business is brisk as building materials have become more readily available. But Jesus hesitates to grow his business. Speaking frankly and with direct eye contact, Jesus affirms that “The rules of the game are still very much in flux, there is much uncertainty about laws and policy.” For example, prices of some building materials have been skyrocketing and he still must purchase retail, as TCPs do not have access to the state-owned wholesaler, Almacenes Ferretería. And he recalls the monetary instability of the 1990s, when inflation and a sudden, sharp devaluation cost him dearly.

His two assistants (a brother and a cousin) report being paid a handsome 5 CUCs per day as compared to the monthly income of 250 pesos (roughly 10 CUCs at the official 24:1 exchange rate) earned by some state construction workers. The assistants add with pride that “Jesus is a very good construction worker.”

Another experienced builder, Ricardo Veranes (Figure 4.5), 57 years old, responded affirmatively when the Minister of Construction asked his employees whether they might be interested in leaving the ministry and forming a cooperative.<sup>22</sup> With 38 years of experience, Ricardo had managed 500 workers, earned the highly respected title of “National Hero of the Republic of Cuba,” and served as

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<sup>22</sup> The conversation with Ricardo Veranes took place in Santiago de Cuba on September 22, 2013.



FIGURE 4.5. RICARDO VERANES,  
COOPERATIVE PRESIDENT



a deputy in the National Assembly representing Santiago de Cuba, his hometown and the nation's second largest city. Ricardo took up the challenge and selected 35 quality laborers, initially hired as contract workers under his TCP license, and then as members of a new cooperative named after a revolutionary martyr, Armando Mestre Martinez. As president, Ricardo is confident his cooperative can succeed based on several advantages: more flexible labor policies (easier to penalize or dismiss incompetent performers and avoid hiring redundant administrative personnel), freedom to select projects, and capacity to negotiate prices—even as the timely availability of construction materials and access to bank credit remain problematic. Moreover, having just suffered a direct

hit from Hurricane Sandy, Santiago is badly in need of reconstruction services, and business is brisk. The cooperative, which is governed by an executive committee and an assembly of all of its members, has set wage policies to stimulate productivity, and profits will also be distributed according to measures of labor discipline and performance. Wages already exceed those paid to government construction workers by a wide margin. Consistent with cooperative principles of “solidarity and community,” Ricardo will offer discounted prices to some clients with less capacity to pay.

## Electronics Repair

“Enrique Guerra Celulares” is the name of the repair shop for mobile phones and other electronic appliances located within the owner’s home in Cienfuegos. An electrical engineer, Mr. Guerra spent his career working in a state-owned enterprise, but he also spent four years as a technician accompanying a Cuban medical mission in Venezuela, which enabled him to save some of the 10,000-15,000 CUC he has invested in his repair shop.

His biggest problem is finding parts to repair his clients’ electronic gadgets. He goes so far as to order parts via the internet from China and has them delivered via DHL, working with friends abroad who make the payments. Friends also bring in parts, one at a time, when they return from travels abroad, to avoid having to pay heavy import levies on larger shipments. “It’s an economy of ants,” Mr. Guerra laments.

The other problem is weak consumer purchasing power. With a healthier economy, more Cubans would have cell phones and other electronic equipment, Guerra asserts, and demand for his business would grow.

FIGURE 4.6. ENRIQUE GUERRA CELULARES (MOBILE PHONE REPAIRS)



### Transportation: The Business of Nostalgia

The proud founders of Nostalgic Cars—a fleet of eight gleaming 1950s model Chevrolets—Julio and Nidialys Acosta count among their recent customers Beyoncé, Susan Sarandon, and well-heeled Cuban-American business executives. “American clients are the best,” report the couple, who previously worked as engineers for SOEs. “Americans are well-mannered, cultured, and interested in learning—and they tip well, too.” Nostalgic Cars collaborates with licensed U.S. travel service providers to arrange outings for U.S. groups on cultural and educational visits. A friend living in the United States purchases replacement parts for their vintage Chevys and arranges for their transfer—via other friends, family, or mules—to Cuba.

Although “Nostalgic Cars” is registered in Cuba as a trademark, it is not a legal entity but rather an informal association as each of the drivers must register as individual *cuentapropistas*, since Cuban law still restricts the quantity of cars an individual can own. The Acostas anticipate that new regulations will allow them to formalize their business as a cooperative: “We will be able to sign contracts with SOEs and get paid via check. The firm might be able to buy and sell cars—and maybe even import freely!” But the business couple fears too fast an economic opening: “We won’t be able to compete if the government lets wealthy foreigners come in and buy up a fleet of 40 classics without blinking twice.”

Rather, the Acostas look forward to partnering with SOEs. They have held initial meetings with representatives of two large state tourism agencies, Havanatur and Cubatur, offering to serve their clientele; currently, the Acosta's main competitor, the SOE Gran Car, monopolizes contracts with the official entities. Meanwhile, the Acostas drive around Havana in their new Japanese model car, live in a spacious two-bedroom home, and enjoy a middle-class life style, determined "to pursue their passions for restoring classic cars and progressing economically by building their business."

FIGURE 4.7. ENTREPRENEURS: (FROM LEFT) CARLOS, 3-D MOVIE THEATRE; ELOYÑA (ON RIGHT), ART GALLERY OWNER AND ARTIST; GUILLERMO, FITNESS CENTER OWNER; LIDUSOY, DANCE INSTRUCTOR



## BOX 1. Frustrated Ambitions

Here are snapshots, as told to the author, of individuals who asserted that current rules and regulations and administrative practices were preventing them from realizing their business ambitions, in some cases entirely so. Out of ignorance or distrust, some may be underestimating the opportunities opened by the recent reforms.

- Senior scholar specializing in the Cuban economy, associated with prestigious think tank, anxious to form with colleagues an international consulting firm, a professional service not yet covered by the magical “181” (now 201) authorized activities.
- Software developer, typical of underemployed graduates in information technology, unable to find remunerative work in her field, making more money selling artisan crafts at Havana artisan fair. Proclaims that she cannot open a private software firm because it is not allowed in the authorized categories, and because; “You have to be Cuban to understand all the obstacles that we face here.”
- Young architect, currently selling artisan products at “Feria y 23” in Havana, unable to find professional work in sluggish construction market and refuses to work for “Stalinist” military-owned hotel chains where construction jobs are more plentiful.
- Restaurant co-owner who formerly worked for the armed forces and served in Angola, would consider selling his primary residence to generate capital to open a private security firm, but affirms that the authorities would not allow private competition with official security agencies.
- Woman, 31, working in state child care center, wants to open private day care center, and estimates high demand, claims she would not be able to get a license, even though day care appears as one of the officially designated categories.
- Former biomedical researcher, middle-aged woman, now working as tour guide but without authorization because, she says, her new profession is not yet a TCP category—the official Havanatur tourism agency does not welcome competition. Once the regulations for cooperatives are clarified, she hopes eventually to form a tourism cooperative with friends who speak various European languages.
- Two women publicists—one an accomplished media personality, the other a recent university graduate—working as consultants to large restaurants without a TCP license, asserting their profession is not yet an authorized category of TCP. In their consulting work, they are struggling to remake the existing profession of “social communications” which is focused on information flows within the firm, to a more modern communications apparatus with customers and markets outside the firm. They make use of digital media including cell phones, Facebook, TripAdvisor, and customized websites but the government denies advertising access to TV and radio and to government-controlled print media.
- Seasoned fisherman, living in the shadow of the 18th century fortress Castillo de Jagua in Cienfuegos, wants to form a fishing cooperative but believes that the cooperative regulations don’t yet apply to fishing.
- Another successful fisherman, who invested the capital he earned fishing to open a modest fish restaurant, now wants to expand his fishing business and purchase a larger boat—but where to find one to purchase? He also wants to be able to directly supply his restaurant with his own catch but is required to sell his catch to state distributors who will turn around and re-sell his fish to his own restaurant.
- Former executive in a large state wholesale company, now a taxi driver with a 1995 air conditioned Citroen, wants to open a retail store—but not until the government relaxes its monopoly on merchandise imports.
- Husband-and-wife owners of a successful neighborhood churros stand on their front patio would like to expand to a second space but report that they are unable to find necessary machinery at a reasonable price, and that there are “too many bureaucratic hassles” to rent retail space from government landlords.

## 5. Lessons from the Case Studies and Conversations

**F**or early movers, profit rates can be very rewarding. Facing little competition, successful Cuban businesses can hope to recoup initial investments in one to three years—a 33 percent rate of return, at the outside. Characteristic of the times, the young owners of Piscalabis anticipate such success; and in one prosperous residential district in Havana, the owner of a recreational 3-D cinema catering to youth anticipated retiring his seed capital within eight months. In competitive markets where barriers to entry are low, there will be downward pressure on profits and businesses will have to differentiate their products. Restaurants, for example, will want to enrich their menus with specialty cuisines as well as improve the quality of service: the new Havana restaurant Los Compadres is now offering good Mexican cooking. At the same time, a favorable external shock—such as another surge in U.S. tourism resulting from a further liberalization of U.S. travel regulations—would expand the consumer market and bolster business revenues and profits.

Some private businesses also benefit from the severe price distortions and implicit subsidies that characterize the Cuban economy. Entrepreneurs that can purchase inputs at repressed prices but sell their products at market “negotiated” prices can generate extraordinary rates of return. Establishments that receive revenue in hard-currency CUCs but pay workers in undervalued Cuban pesos (the CUC—Cuban peso exchange rate is 1:24) are especially well positioned to engage in “rent seeking” behavior. For example, income from one meal at a paladar could suffice to pay a waiter’s wage—most likely less than 30 CUC a month before tips—for a month.

Interestingly, Cuban businesses have proven able to tap a wide variety of sources for their investments. It is a common myth that Cuban householders have no savings: Our conversations revealed domestic capital accumulations with origins in sources as varied as savings from previous businesses; sales of assets such as cars, homes, or farmland; retained income from working as waitresses and bartenders at high-end paladares; and unspent bonuses received in CUCs by

employees in joint ventures. Other entrepreneurs made use of savings earned in government-sponsored international missions in Venezuela and elsewhere, or in postings abroad as diplomats and military attachés, or as marketing representatives of Cuban SOEs. Capital is scarce, but not as negligible as sometimes believed, and suddenly appears out of nowhere when opportunities beckon. And friends and families living abroad are also contributing seed capital, as donations or interest-free loans, and occasionally as equity seeking profits. Conversations revealed cases where foreigners, from Canada to Argentina, were willing to inject capital as “silent partners”; for example, to back what one investor hopes will become one of Havana’s first fast-food home delivery services.

## Constraints on Entrepreneurial Spirits

Without question, Cuban entrepreneurs face many constraints.<sup>23</sup> The most glaring is the national banking system. Accustomed to passively lending to large SOEs, state banks are unfamiliar with evaluating projects or taking risks, and loans of any size must be approved at banks’ national headquarters. Three of the state-owned banks—Banco Metropolitano, BANDEC, and Banco Popular de Ahorro—are authorized to lend to *cuentapropistas*, but the financial resources that the central government has allocated for TCPs are earmarked primarily for agriculture and for home remodeling by the poor, leaving little for other business sectors. Furthermore, many Cubans are suspicious of state institutions, fearing arbitrary victimization or tax audits, and are unfamiliar with banking documentation and procedures and with formats for business plans. Cubans are denied access to international banking by the Cuban government and by U.S. financial sanctions.

Another serious scarcity is inputs of all sorts: spare parts for repairs of appliances and mechanical equipment and transport vehicles, basic materials for construction, and vital ingredients for restaurant menus. Moreover, TCPs are denied access to wholesale markets and so are forced to pay retail prices, like any household consumer. The government maintains a monopoly on imports and customs officials heavily tax goods imported by travelers even if “for personal use” above minimum values.

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<sup>23</sup> The findings here are generally aligned with those in Joseph L. Scarpaci, “Fifteen Years of Entrepreneurship in Cuba: Challenges and Opportunities,” *Cuba in Transition* (Association for the Study of the Cuban Economy, ASCE, 2009). In a non-randomized survey of 154 *cuentapropistas* in Havana conducted in 2008, interviewees prioritized these challenges: supplies (costs and availability), taxes and licensing fees, and inspectors and regulations. The Scarpaci survey used a “snowballing technique” to locate interviewees and focused on the very small-scale micro-entrepreneurs typical of the period, in contrast to the author’s purposive conversations with entrepreneurs independent of each other, to yield a more varied sample of TCPs, and which sought to identify future-oriented businesses with growth potential. Whereas less than five percent of the Scarpaci sample cited “weak demand” as a principal challenge, the author’s interviewees focused on impediments to future expansion, such as weak consumer demand, credit scarcity, and the uncertain business climate.

One very visible exception to scarcity is the bustling new wholesale market for fresh produce located in the Boyeros district near the Havana airport (Figure 5.1). On high volume days, some 100 privately-owned trucks bring in bags and boxes loaded with fruits, vegetables, and grains—rice, beans, peanuts, malanga, gourds, potatoes, tomatoes, cucumbers, chilies, pineapples—that originate on private farms and cooperatives in neighboring provinces (“farm to table”). The buyers are other TCPs: vendors with stalls at the food markets, street hawkers with their carts, and paladares offering designer cuisine. The wholesale prices to be set by supply-and-demand and with active haggling: Buyers are willing to pay prices above those at government shops for the better quality or timeliness of supply.

FIGURE 5.1. MERCADO DE ABASTOS (WHOLESALE MARKET), BOYEROS, HAVANA



Another often overlooked constraint facing TCPs is the scarcity of commercial rental space, should an entrepreneur want to expand outside his or her home, or to select location on the basis of market opportunities rather than on dwelling happenstance. There is no shortage of empty store fronts but they are owned by government entities that have little incentive to rent: taxes on commercial rental income are high. Regulations governing public buildings and land use are still works-in-progress; a recent official publication admitted that the old colonial town centers, with their rich tourist flows, are only beginning to study land values in order to be able to rent to TCPs.<sup>24</sup> However, government entities have been disposed to rent to pre-existing tenants, e.g., beauty salons, barbers, cafeterías (sandwich and snack shops), and produce markets.<sup>25</sup>

<sup>24</sup> Oficinas del Historiador, *Luces y Simientes: Territorio y Gestión en Cinco Centros Históricos Cubanos* (Ediciones Boloña, 2012), pp. 113-114 for Havana, p. 401 for Cienfuegos.

<sup>25</sup> *Juventud Rebelde* reported approval of rental space to 1,183 food establishments, April 16, 2013. Earlier, Cuban state television had mentioned that 5,000 private businesses were renting space from state entities, *Cubaencuentro* blog, February 10, 2012.

More generally, the business climate remains very challenging. Many Cuban consumers lack purchasing power and GDP growth has been disappointingly sluggish. While the political system has been stable, the rules of the economic game are shifting “*sin prisa pero sin pausa*” (without haste but without pause) in President Raúl Castro’s words, and the end state that policymakers have in mind remains hazy. As the system shifts from state control to a more hybrid system with a growing non-state sector and market signals, regulatory mechanisms that protect the general public and consumers will be required—and this will take time. For example, the government is considering a system to regulate the individual bed and breakfast establishments to ensure basic standards for tourists. Another example: The government will want to relax the narrow scope for business publicity, potentially creating a system that provides information to consumers while protecting the beauty of cityscapes—but it’s anyone’s guess as to just where this balance will be struck.

Looking forward, will the government continue to relax restrictions on capital accumulation and business growth? Legally, a person can still only own two houses (one urban and one rural or beach “vacation” home), restaurants are limited to 50 seats, and policies governing expansion into additional locations or franchises appear to be works in progress. Limits have been removed with regard to the number of employees many businesses can contract, but if a private firm’s payroll surpasses five workers, the payroll taxes increase disproportionately—a clear disincentive to business expansion.

As firms grow, the tolerance of the state sector for competition will be tested. The government remains suspicious of “exploitation” in the private sector, even though in fact private-sector wages are typically far superior to those paid to public-sector employees.<sup>26</sup> If the government is concerned that market mechanisms will increase inequalities rather than repress growth, a much more efficient solution is to implement progressive systems of taxation and social services.

The government is under pressure from its educated population to expand the authorized categories to allow professionals, such as lawyers and architects, to exercise their talents on their own or in partnerships (cooperatives). Already there are positive examples of TCPs hiring professionals such as accountants, as permitted by current regulations, and the construction of such value chains would give new hope to the frustrated middle classes and slow the damaging brain drain. Within the designated activities, Group 2—the production and sale of artisan and industrial products—

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<sup>26</sup> A 2008 survey of 154 TCPs found their net income to be 386 percent compared to the average Cuban salary. Scarpaci, op.cit, Table 1, p. 351. A more recent study asserts that in Havana private cafeterias pay their employees about 2 CUC daily, 2.6 times the province’s average salary. Carlos Garcimartín, Omar Everlenny Pérez, and Saira Pons, “Reforma Tributaria y Emprendimiento,” in José Antonio Alonso and Pavel Vidal (eds.), *Quo Vadis, Cuba?* (Madrid: La Catarata, 2013), chapter 4, pp. 181-182. However, these findings of average salary do not by themselves negate the possibility of TCP owners mistreating their employees, especially if they are not legally registered (“informal”).



enumerates only 10 activities, discouraging entrance into manufacturing. Eventually, it is being proposed in academic circles, the government could move from its “positive list” approach to a limited “negative list” of prohibited occupations. In the meantime, clarification of what occupations are allowed under existing regulations might encourage new entrants.

Beneath the surface, many TCPs grumble about the negative attitudes and petty—and sometimes not so petty—persecution by government inspectors and police. Disturbing stories of crippling fines and imprisonment for minor offenses, cancellation of licenses and confiscation of assets, are commonplace. Encounters with the judicial system are expensive not because of formal legal fees but rather due to the requisite under-the-table payments to soften penalties. Fearing retribution, some TCPs purposely restrain their growth so as to not capture the attention of the authorities. The population’s simmering resentments are communicated by the ubiquitous gesture of two fingers tapping the shoulder: to signal military stripes and unaccountable, overbearing authority. President Raúl Castro has spoken out against lingering attitudes that discriminate against TCPs and some business owners report a reduction in official harassment, but more remains to be done if the private sector is to feel fully legitimate and well protected in Cuban society.

### Taxation: Learning by Doing<sup>27</sup>

As businesspersons everywhere, Cuban entrepreneurs complain about their tax burden. Determining the actual tax burden, however, can be difficult, especially in the Cuban case where the government releases few relevant statistics. For many Cuban *cuentapropistas*, the effective tax burden is very much a function of the veracity of their reporting of revenues. In the absence of credit cards or some other reliable system to record sales, and the incapacity of the fledgling tax administration to properly audit returns, it is widely assumed that many firms grossly under-report revenues.<sup>28</sup> In such cases, effective tax rates would be lower than the legal rates, and in practice less of an oppressive constraint on business success than they might appear at first glance.

TCPs face a number of taxes, including a monthly licensing fee which varies by occupation and must be paid regardless of revenues, and small contributions (generally 87.5 Cuban pesos or under \$4 per month) to the social security system. But potentially the heaviest is the tax on net revenues (profits) which must be paid on a monthly basis and then adjusted at year end, and which

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<sup>27</sup> I am indebted to Saira Pons Pérez of the Center for the Study of the Cuban Economy (CEEC) for assistance in understanding the evolving Cuban tax regime. See her excellent “Reforma Tributaria y Emprendimiento,” (with Carlos Garcimartín and Omar Everlery Pérez), in José Antonio Alonso and Pavel Vidal (eds.), *Quo Vadis, Cuba?* (Madrid: La Catarata, 2013), chapter 4, pp.148-188; and “Emprendimiento y Reforma Tributaria en Cuba,” PowerPoint presentation at the Latin American Studies Association (LASA), June 1, 2013.

<sup>28</sup> Earlier studies of TCPs also found widespread underreporting. See Ted Henken, *op.cit.*, a 2002 study based upon 64 in-depth interviews of TCPs, and Archibald Ritter (1998, 2006), *op.cit.*

rises quickly from 15 percent on net income from 10,000-20,000 pesos to 50 percent on net income over 50,000 pesos.<sup>29</sup> Many businesses receiving a significant portion of their revenues in convertible currency pesos or CUCs (which must be converted for tax purposes at the 24:1 official exchange rate) would quickly surpass the \$2,000 mark and fall into the 50 percent bracket. In fact, the effective tax rate on profits could rise even higher, because the authorities place various limits on the deduction of costs from gross revenues. Businesses can deduct from their gross revenues only 20 to 50 percent of costs, depending upon their placement within the seven TCP groups (Table 4.1), and some expenses are excluded from eligibility altogether. However, only 50 percent of claimed expenses must be fully documented in tax declarations.

Each month TCPs must also pay a sales tax of 10 percent on gross revenues.<sup>30</sup> In a reminder that some authorities continue to think in terms of a non-market economy, the sales tax is deductible against profits but “cannot result in an increase in retail prices.”<sup>31</sup>

In addition, TCPs with employees must pay (light) social security taxes and a complicated payroll tax. There is no payroll tax on the first five employees. However, the base salary upon which the payroll tax is determined rises with the number of employees: for six to 10 employees, the average base salary is set at 1.5 times the regional average salary; for employees 11-15, two average salaries; and for any additional employees the base rises to three average salaries.<sup>32</sup> This upward-sloping scale discourages business expansion and job creation (or encourages hiring off the books). At the same time, it is noteworthy that the tax code sets no limit on the number of employees and creates rules that apply specifically to larger firms, as though anticipating their creation.

There are also some smaller (some might say “nuisance”) taxes. Businesses that wish to advertise their presence with signs or other commercial propaganda must seek permission from local authorities and pay taxes based upon the precise size of their advertisements. These taxes also vary according to district, ranging from 30 pesos per square meter per month in “urban service centers” to 50 pesos in districts “of high architectural value.”<sup>33</sup> Approvals cannot be taken for granted as authorities, including the municipal or provincial zoning office (Dirección de Planificación Física), will weigh the public interest.

Taxes have been simplified for certain categories of TCPs that are allowed no more than one employee. These TCPs simply pay a fixed monthly quota and social security taxes. But for some

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<sup>29</sup> *Gaceta Oficial*, No. 053, Law 113, Article 26, November 21, 2012.

<sup>30</sup> *Gaceta Oficial*, No. 029, Special Edition, Resolution 298/2011, Articles 26-27, September 7, 2011.

<sup>31</sup> Law 113, Articles 132-139.

<sup>32</sup> Law 113, Articles 234-237.

<sup>33</sup> Law 113, Articles 336-358.

micro-entrepreneurs such as patio snack shops, the fixed monthly quota (which must be paid independently of revenues and varies by type of activity) has been a killer and explains why many TCPs have fallen behind in payments or have simply given up and turned in their registration cards.

In comparative perspective, are Cuban TCPs facing a heavy tax burden? Without access to unpublished official data, or a good estimate of under-reporting, this question is very difficult to answer. But even at 50 percent of net profits (allowing for some under-reporting) plus labor taxes, the Cuban TCP taxes appear roughly comparable to those in some other developing countries. According to a survey of the International Financial Corporation (IFC), the total tax rate (“percent of profits rate”), defined as the sum of the profit or corporate income tax, labor taxes paid by the employer, and property taxes, varies widely across countries (in percentages): Colombia, 75; Brazil, 67; Nicaragua, 67; France, 66; Venezuela, 64; China, 64; Costa Rica, 55; Mexico, 53; Sweden, 53; United States, 47; Dominican Republic, 42; Vietnam, 40; and Chile, 25.<sup>34</sup>

In Cuba, business taxes have been modified repeatedly in recent years; unlike in previous policy cycles, when authorities raised taxes to choke off business growth, now modifications have tended to reduce rates. Not accustomed to having to collect taxes on a large number of private entities, the tax authorities badly need to augment their collection and auditing capacities, and to computerize what is still largely an antiquated paper process. A broader tax base would allow for more revenue and lower rates. The tax regime should be modified to discourage tax evasion and informality, rather to encourage honest reporting and taxpayer participation, and to incentivize investment and job creation.

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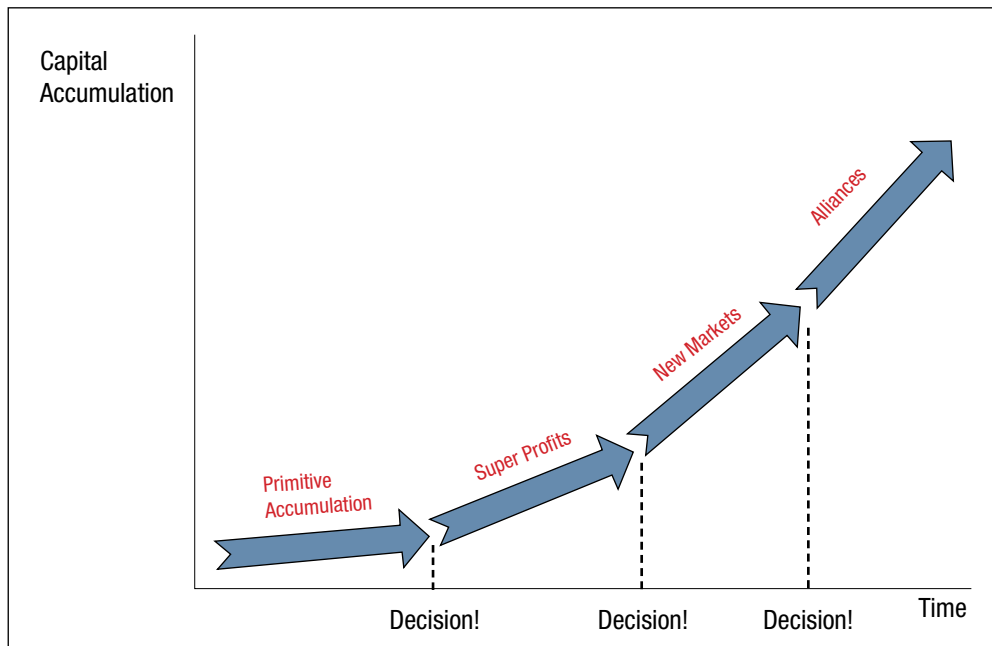
<sup>34</sup> International Financial Corporation, *Doing Business 2012* (Washington, D.C.: IFC, 2012).

## 6. Stages of Capital Accumulation

**T**he majority of Cuban small businesses are new and fragile and many have clustered around food and beverage services. These aspiring entrepreneurs are experiencing a shake-out period and many will not survive. Some will learn from their failures and try again, in another line of business. Inspired by success stories, other Cubans will take the plunge and enter the unfamiliar domain of risk-reward, of personal initiative and accountability, of long hours and relentless 24/7 responsibilities, the constant struggle to locate necessary inputs, to do battle against the many obstacles to profitability placed by hostile or indifferent authorities and by the demanding conditions of contemporary Cuba. (In some households, one breadwinner will hold onto the warm security of public employment for the guaranteed income and other perks.)

The new businesses can immediately add jobs and provide goods and services but cannot reasonably be expected to become major centers of capital accumulation overnight. Those who criticize the newly emerging private sector for not adding significantly to national savings fail to understand that the growth of the Cuban private sector will necessarily be a gradual process, but already there are firms that have surpassed the “micro” stage to become dynamic enterprises. In the specific context of Cuba’s political economy, we suggest four stages during which select private businesses can, step by step, add to household incomes, move forward to generate hefty profits, forge domestic value chains, and ultimately build alliances with state-run firms and foreign partners. If the authorities establish a favorable climate for business expansion, the private sector can eventually become a center for capital accumulation, domestic savings, and tax revenues, and a strong pillar in Cuba’s new development strategy.

**Graph 6.1. Stages of Capital Accumulation and Key Government Decision Points**



**Stage 1. Primitive household accumulation:** In these early years of economic opening, many new small businesses, self-financed or benefitting from modest injections of savings from family living abroad, typically have timid attitudes and modest goals. The owners do not think of themselves as business executives but rather as workers earning extra “pocket money” to lift family living standards. Many TCPs will never escape this early stage, their horizons narrowed by their modest aspirations, their families living too close to the poverty line, consuming any profits to meet basic necessities, even more so as the paternalistic state cuts subsidies. Some that acquired their initial savings from illicit businesses, and without a record of paying taxes, are especially hesitant to deposit cash in state banks where they might face questions as to the origins of their assets. Fearful of authority and uncertain about the direction of policy, some micro-business owners will prefer to store any savings “under the mattress,” or will invest in home improvements, new furniture and household appliances. Of our case studies, Jesus (the builder) would seem to fall within this stage of primitive household accumulation.

Nevertheless, some outstanding TCPs, whether from hard work and mounting ambition or great location and good luck will begin to generate significant profits and will raise their sights. As they develop a track record of honest income and healthy relations with government entities, they will gain the confidence to invest and grow.<sup>35</sup> If given the opportunity presented by an improving busi-

<sup>35</sup> In his survey of 850 micro-businesses in Central America, Michael J. Pisani found a similar range of possible outcomes, from “subsistence to prosperity.” Op.cit, p.127.

ness climate, “Enrique Guerra Celulares” and Mariano (the accountant) could make this momentous leap forward. Among the key decisions facing the government at this stage: facilitating easier access to supplies and at wholesale prices (as it has promised to do), and making more retail space available for leasing or even purchase. Already the Cuban government has been modifying policies to make life easier for TCPs and could continue in the direction of lessening tax burdens (for example, establish net income rather than gross income as the tax base and remove artificial limitations on cost deductions) and relax the fixed monthly licensing fees for “simple” businesses.

**Stage 2. Early Mover Profits:** Some small businesses enjoying early mover advantage in underserved markets and with high turnover rates and wide profit margins can grow quickly. Some early mover TCPs benefit from indirect subsidies, as when they purchase inputs at low government-fixed prices, pay wages in national currency benchmarked against low government-set salaries, or operate in markets protected from competition from imports or where national state-owned enterprises produce only low-quality alternatives. Some of the larger restaurants in metropolitan areas are visibly benefiting from these highly favorable market conditions; where these paladares succeed in offering a well-branded dining experience with consistent quality, profit margins can be extraordinarily high. Of our case studies, Nostalgic Cars and Magalyfica could fit this mold, and the Pisco-labis gift shop aspires to as well.

At this stage, government decision makers could begin to address the massive maze of regulatory burdens, so that a simplified regulatory regime serves to protect the public interest rather than to empower government inspectors prone to abusing their discretionary authority. The government could also issue new guidelines on public advertising which recognizes that the circulation of information makes markets more efficient and can better inform consumers while honoring legitimate concerns for the public interest and environmental esthetics.

**Stage 3. Growth and Diversification:** Successful private firms—such as our composite B&B and potentially Pisco-labis and the paladar Las Mamparas—will seek to expand and diversify their lines of business and points of sale. They may seek to invest in their own value chains, in businesses that supply their inputs or market their products. Successful entrepreneurs may also seek to diversify into new lines of business, including related ventures; restaurant owners might invest in transportation, just as the owner of a retail outlet might invest in the production of its sales items. This profitable private sector could rapidly move into a dynamic stage of growth and diversification.

At this stage (2013-2015), the government should eliminate disincentives to growth, such as the upward-sloping tax base on the number of employees, and arbitrary quantitative restrictions, as on the number of seats in restaurants. The authorities should shake their suspicions of capitalist

accumulation, their fears that robust private firms may escape official control and compete with SOEs. Rather, competition with SOEs should be welcomed, as a driver to improving their performance. The legitimate goal of limiting concentration of assets and wealth could be better achieved through an effective, progressive tax system. (However, some restrictions might be maintained in the incipient real estate market, which remains very imperfect and subject to abuse.)

**Stage 4. Strategic Alliances with SOEs and FDI:** Successful firms will quickly bump up against the many limitations of the Cuban reality. National capital markets are narrow to non-existent. Domestic demand is weak. In many sectors technology lags badly behind global standards. And firms may run up against unfair competition by powerful SOEs. As they encounter such problems, firms may seek solutions in alliances with SOEs and with foreign partners (foreign direct investment, FDI)—if they are permitted to do so. Only through such strategic partnerships will the Cuban private sector be able to access the capital, technology, and markets firms need to elevate productivity and create good jobs. Only through such partnerships will private Cuban firms be able to integrate into regional and global supply chains and compete on international markets, generating badly needed exports and contributing to Cuban prosperity.

State-owned enterprises are being granted greater autonomy from formerly powerful ministries, in favor of operating as holding companies. Beginning in 2014, some SOEs will be allowed to retain up to 50 percent of their profits, and to set some investment priorities and wage rates.<sup>36</sup> Firms that persistently lose money will be allowed to close or be acquired by other firms, the government says, rather than be bailed out with state funds, as has been the case. These more profit-oriented SOEs should be more inclined to seek alliances with efficient private firms, whether domestic or foreign owned, and would make for more compatible partners.

The Cuban government can accommodate rising entrepreneurs by offering them a level playing field where they can compete fairly with SOEs, and by promoting active collaboration and strategic alliances between public and private entities, to mutual benefit. Furthermore, an opening to private domestic capital could help pave the way to welcoming investment by the Cuban émigré community—the Cuban diaspora living in the United States but also in Spain, Canada, and Latin America. Some diaspora entrepreneurs have access to large-scale investment capital and could integrate their Cuban operations into trans-national value chains. Other diaspora investors can help to finance limited partnerships with relatives and friends on the island, to jump-start small- and medium-sized enterprises (SMEs) and generate a business climate of renewed optimism and

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<sup>36</sup> Marc Frank, "Cuba to Embark on Deregulation of State Enterprises," *Reuters*, July 8, 2013.

confidence in a better future. Taking advantage of Cuba's central location, these SMEs can not only supply domestic demand but also sell into markets around the Caribbean basin and beyond.

## Soft Landing for the Cuban Economy?

Successful business owners gain personal autonomy and self-confidence and develop an awareness of their business interests. These smarter executives learn how the decisions of government determine such economic variables as prices, taxes, subsidies, and interest rates, and how the results impact their own firms.

In the case of a socialist system, where government entities and state-owned enterprises control resources and markets, relations between the public and private sectors take on special significance in configuring business opportunities. Using their strong political connections and in many cases dominant market positions, SOEs are often capable of blocking the market expansion opportunities of competitors. In such circumstances, private firms can seek to marshal their own political capital to demand a level playing field where they can compete on the merits, or they can seek to join forces and form public-private alliances with strong SOEs.

Looking forward, the Cuban political leadership will decide whether they are comfortable with a political economy that is open to collaboration and sharing benefits with a dynamic private sector, or whether they demand a closed system that seeks to maintain state monopolies and sets limits on profitable options open to private competition. The economic and political implications of this crossroads decision will be very great.

An inclusive, open system can create perceptions of economic opportunity and mutual interest. If market forces are allowed to operate, over time the public-private balance of power will almost certainly shift in the direction of private enterprise, with its greater efficiencies and focus on profitability. But the power shift can be gradual and leave plenty of space for public ministries and firms—and their senior managers—to retain significant power and resources. Under such circumstances, will government leaders, long used to monopolizing political and economic power, be willing to share opportunities with an emerging private sector? Will the leadership of the Cuban Communist Party decide that their political survival is best served by sharing economic power?

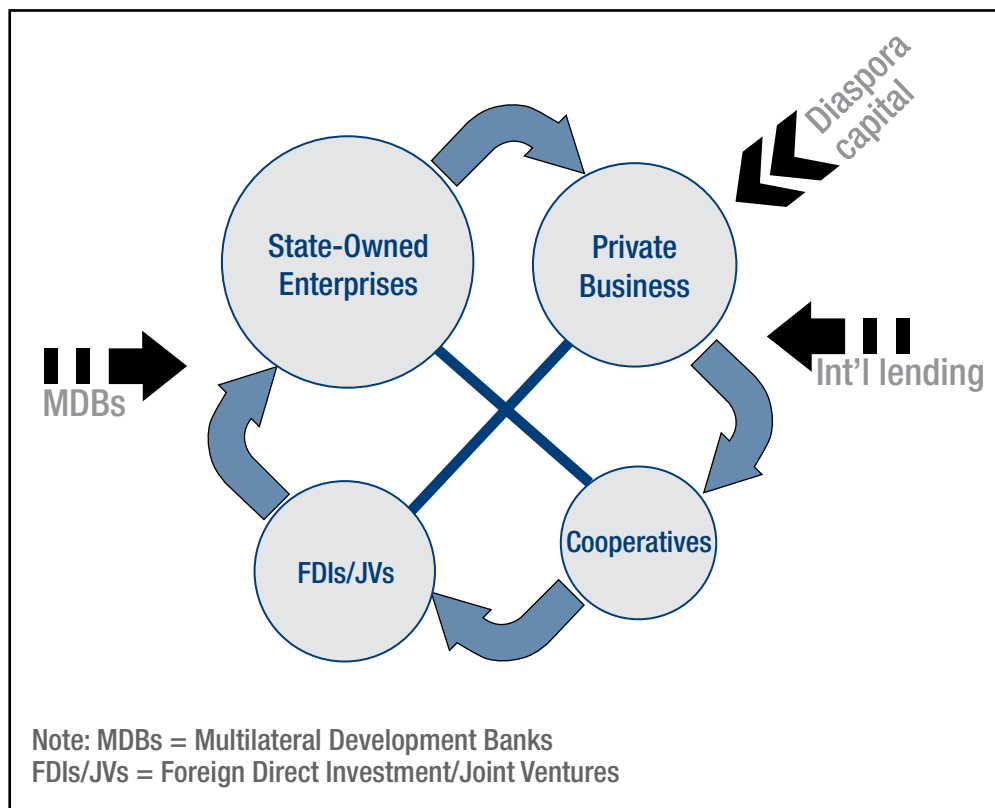
The soft landing scenario builds toward an internationalized, hybrid market socialism, where relations among the more efficient SOEs, growing private firms, innovative Cuban cooperatives, and risk-taking foreign investors are driven primarily by market incentives, even as some public-private partnerships inevitably retain a political tint (Graph 6.2). A strong local private sector gradually



emerges, capable of surviving even as the economy opens to foreign capital. In this favorable scenario, the Cuban economy becomes increasingly open to international trade and investment flows and re-integrates into regional and global markets. This hybrid system is stable in the medium-term (assuming complementary economic reforms and no major negative external shocks), even as the public and private sectors jockey for hegemony in the long run.

There is an alternative option that may tempt some of the Cuban leadership: stalling the reform process, hunkering down, praying that friendly states such as China and Russia will extend major new lifelines, despite their evident reluctance, and that the *Chavistas* will remain in power in Venezuela and sustain generous shipments of highly subsidized petroleum. The inertia built into the decades-old system—multiple veto points and uncertain approval authority, entrenched bureaucracies that subsist on “rents” and block innovation, a visceral distrust of international markets—are real breaks on change. If the senior leadership retreats or wavers, the medium-term outlook could be bleak indeed. Certainly, the soft landing scenario (Graph 6.2) holds greater promise for most Cubans, especially for the restless youth (and as will be postulated below, for the United States).

**Graph 6.2. Soft Landing in Cuba, circa 2020**



## 7. The Post-Revolutionary Middle Classes<sup>37</sup>

In the immediate aftermath of the 1959 revolution, hundreds of thousands of Cubans—some 10 percent of the population—abandoned their homes and fled the island. The wealthier districts of Havana appeared to have been targets of a neutron bomb, dissolving the people and leaving only the luxury villas and trendy apartment buildings. Those middle-class Cubans that chose to remain confronted the dilemmas captured in the classic 1968 film *Memories of Underdevelopment*, in which a disoriented intellectual struggles to adapt to the new socialist society.

The departing upper and middle classes left behind a Cuba of impoverished workers and farm hands. For many years the revolutionary government claimed to represent these workers and peasants, although in more recent times the government largely avoids divisive class distinctions and simply claims to represent the entire Cuban nation. But in the intervening decades—largely unnoticed—new middle classes have sprung up from within the revolution itself. By decapitating the social pyramid, the revolution had opened the doors to an unprecedented upward social mobility, and the government provided the educational institutions that equipped Cubans to seize the opportunities for social advancement. This seismic socio-economic development—the rise of new middle classes within the post-revolutionary society—harbors important implications for the future course of Cuban economic and political development. Cuba today is very much host to large and growing middle classes, which overlap with (although are not identical to) the private sector.

There are several methods in the scholarly literature for measuring the middle class. For those scholars that use per capita income or consumption, the measures can be either absolute or relative. For

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<sup>37</sup> The plural “middle classes” is intended to suggest the heterogeneity of its occupations in both the private and public sectors, as well as its spread of income levels and spatial locations.

those using absolute levels of per capita income, the thresholds vary from a low of \$2 per day,<sup>38</sup> which essentially defines “middle class” as barely escaping poverty, to the more commonly accepted threshold of \$10-13 of personal income per day, or \$3,650 to \$4,745 per year. The Cuban government does not release detailed data on the social distribution of income, reporting only an aggregated gross national income (GNI) per capita of \$5,539 (2011) or \$15 per day (\$5,539 divided by 365 days).<sup>39</sup> In light of the relatively equal distribution of income and wealth in Cuba (where public sector wage differentials are very compressed and income-earning assets are few), by this measure a large number of Cubans would pass the \$10-13 threshold and rank as middle class.

The World Bank recently declared that 30 percent of the population of Latin America and the Caribbean, or 152 million people, now fall within its definition of middle class.<sup>40</sup> The World Bank experts selected a per capita income threshold of \$10 per day. Not being a member of the International Monetary Fund or World Bank, Cuba does not appear in these rankings. Pooling together five Latin American countries (Brazil, Chile, Costa Rica, Honduras, and Mexico), the World Bank study found that the daily middle class household income per capita (2009) was \$19.30, somewhat exceeding the \$15 daily income for the average Cuban (\$5,539 divided by 365), suggesting that the percentage of Cubans falling within the middle class rankings might be somewhat less than the 30 percent displayed by this comparative group of countries. Among the countries surveyed, the size of the middle class ranged from 17 percent of the population in Honduras, to 37 percent in Costa Rica, to 42 percent in Chile.<sup>41</sup> However, the relatively equal distribution of income in Cuba could offset, at least partially, the nation’s relatively low per capita product.

Other studies define thresholds in terms of relative incomes, based on certain income quintiles or deciles. For example, Easterly uses the middle three quintiles, Solimano the third to ninth deciles; for such relative income measurements the definition itself defines the size of the “middle” class.<sup>42</sup> Birdsall, Graham, and Pettinato prefer a range between 0.75 and 1.25 times the median household

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<sup>38</sup> Abhijit Banerjee and Esther Duflo, “What is Middle Class about the Middle Class,” *The Journal of Economic Perspectives*, 22 (2), pp. 3-28.

<sup>39</sup> United Nations Development Program (UNDP), Human Development Indicators. See also ONE, *Anuario Estadístico de Cuba*, National Accounts, Table 5.12, “selected indicators.” The GNI data is internationally standardized on a purchasing power parity basis. The Cuban data, however, is not without controversy: results could be altered in the event of a major devaluation of the CUC; and the reported per capita income and consumption, which well exceed the average wage rates as paid in Cuban pesos, include government-provided services such as health care, education, and culture, as explained in Oficina Nacional Estadística (ONE), *Anuario Estadístico de Cuba*, “Notas Metodológicas.”

<sup>40</sup> Francisco H.G. Ferreira et al, *Economic Mobility and the Rise of the Latin American Middle Class* (Washington, D.C.: World Bank, 2013). The study fixed the outer bound for the middle class at \$50 per capita per day, only some 2 percent of the population achieving this upper-income ranking. For further elaboration, see “Meet the Real Middle Class,” Feature Section, *Americas Quarterly*, Vol. 6, No. 4, Fall 2012, pp. 50-91.

<sup>41</sup> Francisco H.G. Ferreira, op.cit, Table 5.2, p.147, and Nancy Birdsall, *A Note on the Middle Class in Latin America* (Washington, D.C.: Center for Global Development), Working Paper 303, Table 1, August 2012.

<sup>42</sup> William Easterly, “The Middle Class Consensus and Economic Development,” *Journal of Economic Growth* 6 (4), 2001, pp. 317-35; Andres Solimano, “The Middle Class and the Development Process,” *Serie Macroeconomía del Desarrollo*, No. 65 (Santiago: UN Economic Commission for Latin America and the Caribbean, ECLAC), 2008.

per capita income to define the middle strata.<sup>43</sup> The leading Cuban expert on social trends, Mayra Espina Prieto, places the Cuban Gini coefficient at 0.38,<sup>44</sup> which signals a distribution of income considerably more equal than in most Latin American countries which hover around 0.50,<sup>45</sup> such that a large percentage of Cubans would likely fall within a range of the median income.

Alternatively, middle class status can be defined not by income but by occupation. Cuban government statistics break down employment into five categories: manual workers (skilled and unskilled construction workers, mechanics), professional/technical (certified skilled workers including engineers, teachers, doctors, and nurses), clerical (office employees), service workers (including barbers, restaurant personnel), and executives. Roughly speaking, if we include those that fall within the professional/technical (1.488 million), executives (249,000), and clerical (269,000) categories as middle class professionals, as commonly discussed in the literature, 40 percent of the occupied labor force (totaling 5.01 million in 2011) would fall within the middle class.<sup>46</sup>

Finally, middle class can be defined by certain social achievements or values, such as educational attainment; women's participation in the labor force; indices of economic security; and consumption baskets or aspirations:

- Education: For the Latin American middle class in the World Bank survey, the mean years of education is 10.4, signaling at least some secondary education.<sup>47</sup> For all Cubans, the mean years of schooling is nearly the same (10.2).<sup>48</sup> Thus, if educational attainment—possessing human capital—is given a large weight in defining middle class, as is often the case, most Cubans would qualify.
- Female labor force participation: Female labor outside the home is a mark of modernity as well as a source of household income. In Latin American households considered middle class by the World Bank, roughly two-thirds of the women work. The female participation

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<sup>43</sup> Nancy Birdsall, Carol Graham, and Stefano Pettinato, "Stuck in the Tunnel: Is Globalization Muddling the Middle Class?" *Center on Social and Economic Dynamics Working Paper No. 14* (Washington, D.C.: Brookings Institution, 2000). In their minds, the middle class is "the large group of households that are neither wealthy nor poor, but that form the backbone of both the market economy and of democracy in most advanced societies. Op. cit. p.1.

<sup>44</sup> Mayra Espina Prieto and Viviana Togo González, "Structural Change and Routes of Social Mobility in Today's Cuba: Patterns, Profiles, and Subjectivities," in Jorge Domínguez et al, *Cuban Economic and Social Development: Policy Reforms and Challenges in the 21st Century* (Cambridge: Harvard University Press, 2012), p.270.

<sup>45</sup> International Monetary Fund, *Western Hemisphere Regional Economic Outlook* (Washington, D.C.: IMF, May 2013), Table 2.3, p.24, based on data from Socio-Economic Database for Latin America and the Caribbean (SEDLAC).

<sup>46</sup> Oficina Nacional Estadística (ONE), *Anuario Estadística de Cuba 2011*, Workforce and Salaries, Table 7.8, "Classification of the workforce according to categories and sex." Admittedly, some workers classified as "clerical" or "manual" might fall below the middle class threshold by some definitions, while some workers classified as "services" might well rank as middle class. This measurement is further complicated in the Cuban case by workers holding more than one job, e.g., GESPI, and by the countries' "inverted pyramid," whereby taxi drivers and bellhops with access to CUC can earn more than physicians and university professors paid in national currency (CUP).

<sup>47</sup> Nancy Birdsall, *A Note on the Middle Class in Latin America*, op.cit., Table 6.

<sup>48</sup> UNDP, Human Development Index. In the UNDP's education index (2012), Cuba ranked the highest for Latin America. See <http://hdrstats.undp.org/en/tables/>.

rate in Cuba is only moderately lower, at 60 percent.<sup>49</sup> More broadly, Cuba scores well in the “Gender Inequality Index” of the United Nations Development Program (UNDP), virtually tied for best performance in the Latin American and Caribbean region with Barbados and Costa Rica.

- Fertility rates (or size of households): Lower fertility is associated with middle class status and Cuba displays the low rates characteristic of developed societies. Nearly 100 percent of Cuban women report access to contraception techniques and fertility rates are under 2.0, the lowest in the Western Hemisphere.<sup>50</sup>
- Home ownership and enrollment in social security systems: In these two indicators of economic attainment and security, Cuba scores highly, reporting that over 80 percent of Cubans own their homes (albeit too often in deteriorated status), many with registered titles, and with the mandatory inclusion of the TCPs and cooperative members nearly the entire labor force is covered by social security pensions.<sup>51</sup>

So by several measures—such as educational attainment, women working outside the home, women’s access to contraception and reproductive rates, and common indices of economic security—Cuba looks very much like a middle class society. But there is one measure whereby Cuba would certainly not qualify: access to individual consumer items. One characteristic of middle class values is an elasticity of demand higher than one (that is, the desire to spend more than one earns).<sup>52</sup> Frustrating for many Cubans, their homes lack all the “stuff”—an up-to-date basket of final consumption goods—associated with middle class consumerism. Few Cubans own their own cars or computers, any appliances they are lucky enough to possess are often in disrepair, and their access to well-stocked retail stores and private services is incipient only. As of 2010, a mere 19 percent of Cubans had telephones (fixed or mobile), compared for example to 97 percent in Costa Rica.<sup>53</sup>

Yet many Cubans display the middle class trait of aspiring to consume. As one wry young man noted, “We’re not *comunistas* anymore, we’re *consumistas*.”<sup>54</sup> Asked by the author for her goals in life, one Cuban in her early twenties blithely responded, “Of course we all want the same things: a car that starts, a smartphone, a computer with Internet access, and a decent home.” Even if they cannot afford them, a surprising number of Cubans are aware of global brands, ranging from Nike

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<sup>49</sup> Oficina Nacional Estadística (ONE), *Anuario Estadístico de Cuba 2011*, National Accounts, Table 7.20, “Other global indicators about population and labor resources in the national economy.”

<sup>50</sup> ONE, “Encuesta Nacional de Fecundidad, 2009.” Available at: [www.one.cu/enf.htm](http://www.one.cu/enf.htm).

<sup>51</sup> Cuba has “the most generous” pension system in Latin America, according to Carmelo Mesa-Lago, *Cuba en la era de Raúl Castro: Reformas económico-sociales y sus efectos* (Madrid: Editorial Colibrí, 2012), chapter 4, p. 200. At 50 percent of public sector wages, average pensions are about 250 pesos (\$10 at the 24:1 exchange rate) per month. However, unregistered informal workers without public-sector jobs would fall outside of the social security system.

<sup>52</sup> Mauricio Cárdenas, Homi Kharas, Camila Henao, *Latin America’s Global Middle Class* (Washington, D.C.: Brookings Institution, April 26, 2011), p.3.

<sup>53</sup> UNDP, Human Development Indicators. Available at: <http://hdrstats.undp.org/en/indicators/112806.html>.

<sup>54</sup> Quoted in Nick Caistor, *Fidel Castro* (London: Reaktion Books, 2013), p. 140.

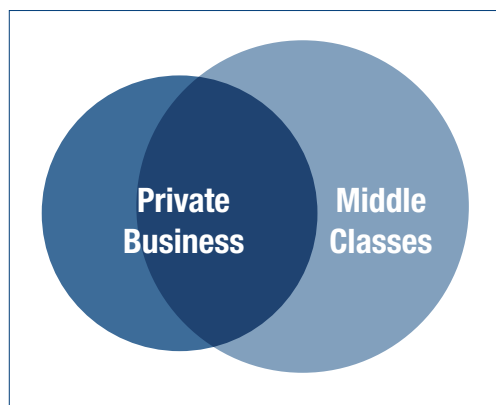
shoes to Nestlé ice cream.<sup>55</sup> A common motivation for emigrating is the desire to experience the middle-class lifestyle associated with the consumer society.

There are few surveys of consumer tastes or of individual attitudes published in Cuba. But one recent academic publication based on 111 interviews confirmed what one might anticipate: that many Cubans are now pursuing strategies of upward social mobility. According to this study, these individualistic strategies seek advancement by movement into the private sector, by supplementing state incomes through moonlighting, and by the use of social networks. Upwardly mobile Cubans “offer an optimistic narrative, feel they are better off than their parents and will further improve their situations”<sup>56</sup>—perceptions and aspirations so characteristic of the middle classes worldwide.

The emerging private sector (numbering as many as 2 million) and the middle classes (consisting of the majority of Cubans by some characteristics) are already defining the new post-Castro Cuba. The old narrative, that the Castros had to pass from the scene before real change could occur, has been discredited by current trends.

As defined in this monograph, the private sector and middle classes overlap (Graph 7.1). Not all in the private sector classify as middle class: some TCPs and small private farmers are doing poorly whereas a select elite might have incomes that would elevate them into an upper class. And as elsewhere, many among the middle classes in Cuba are public-sector employees. But there is large overlap, since many in the private sector, as broadly defined, are generating middle class incomes. This rapidly expanding overlap category of middle class entrepreneurs holds the keys—together with the leadership of the still powerful Communist Party—to the future of Cuba.

**Graph 7.1. The New Cuba: Entrepreneurs and Middle Classes**



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<sup>55</sup> Emilio Morales and Joseph Scarpaci, *Marketing without Advertising: Brand Preference and Consumer Choice in Cuba* (Routledge, 2012).

<sup>56</sup> Mayra Espina Prieto and Viviana Togoeres González, *op.cit.* p. 280.

As noted in the discussion of “stages of capital accumulation,” the Cuban government can accommodate the rising middle class entrepreneurs by offering them a level playing field where they can compete fairly with state-owned enterprises, and by promoting active collaboration and strategic alliances between public and private entities, to mutual benefit.

Over time, the entrepreneurial middle classes will perceive government not just as an irritation but also as the necessary guarantor of a stable and productive business climate. They will want the government to remove the many aforementioned obstacles to TCP capital accumulation and growth. They will expect government to continue to guarantee public safety, to educate a workforce well-adapted to labor market demands, and to provide the necessary business inputs at reasonable cost—energy, transportation, information and communications technology (ICT)—and to adjudicate and enforce commercial contracts. Worldwide, many economic systems function reasonably well even when these systems are far from perfect, but the Cuban middle classes will want their government to demonstrate its intent and capacity to move forward toward better governance, especially with regard to business-related matters.

Emerging middle classes are generally perceived as modernizing forces demanding more open, transparent government and better public services for their businesses and families. Many scholars have also attributed to the middle classes strong pro-democracy preferences, but the Latin American historical experience has been mixed, very much depending on the political context. Middle classes who perceive their opportunities as blocked by authoritarian structures may advocate for democracy, but middle classes frightened by pressures from below from poorer strata may resort to authoritarian solutions (as arguably occurred in the Southern Cone in the 1970s). As a recent study by the U.S. National Intelligence Council concluded, “the rise of middle classes has led to populism and dictatorships as well as pressures for greater democracy. ... Rising expectations that are frustrated have historically been a powerful driver of political turmoil.”<sup>57</sup>

In the Cuba case, the emerging middle classes have been brought up under Cuban socialism and may still honor egalitarian values and be rightly proud of the revolution’s accomplishments in providing universal access to social services, but they also aspire to greater economic opportunity, individual autonomy, and material prosperity. They want to be able to travel and to explore the world—through the internet and in person. It may be overly mechanical to predict that these Cuban middle classes will demand democratic capitalism, but it is safe to imagine that they seek

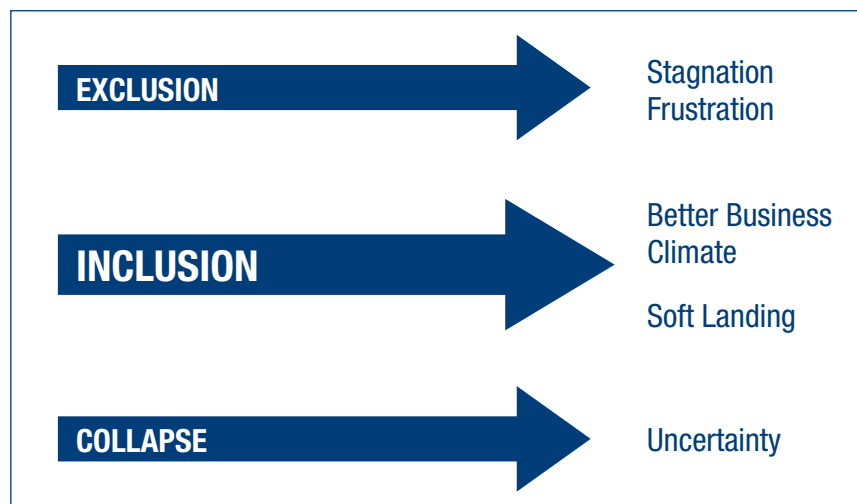
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<sup>57</sup> National Intelligence Council, *Global Trends 2030: Alternative Worlds*, p. 10. For evidence that fear of high levels of street crime can also be used to justify an authoritarian response, see Kevin Casas-Zamora, *The Besieged Polis: Citizen Insecurity and Democracy in Latin America* (Washington, D.C.: Brookings Institution, 2013), chapter 3.

a Cuba that is more “normal,” more like other societies in the Caribbean basin where individuals have access to middle class consumption patterns and have ample opportunities to realize their talents and pursue their careers independent of state control.

Whether these middle classes eventually challenge state power or decide to co-exist with a strong state sector will depend on, among other factors, whether the state is willing to accommodate their interests, or whether it closes off opportunities—at its own peril. The exclusion scenario is likely to result in economic stagnation and political frustration (Graph 7.2). In contrast, over the medium term, the inclusion scenario holds this promise: the emergence of a hybrid market socialism open to the international economy, where a strong state sector both collaborates and competes with the growing private sector, and the entire island is increasingly integrated into regional Caribbean basin and global supply chains.

**Graph 7.2. Cuba’s Future: Three Scenarios**



In the Cuba case, it seems probable that the political attitudes of the emerging entrepreneurial middle classes will turn on the capacity of the government to respond flexibly to their interests. If the government presents a closed system, unrest is predictable, even turmoil is possible. But an open willingness to share power and resources can create conditions for a soft landing for Cuba, a gradual shift toward a more open and prosperous future.

This prospective model of market socialism is distinct from “neo-liberalism,” which in the minds of many Cubans connotes an unbridled capitalism riddled with gross inequalities. In contrast, the inclusion option is anchored in a strong state endowed with strategic enterprises and unfettered regulatory powers. Cooperatives, which are governed by an assembly of the workers which elects an executive board, are another important pillar. As recommended below, all larger firms—whether



foreign or domestically owned, public or private—could be required to exhibit corporate social responsibility: upholding labor standards, demonstrating environmental stewardship, and contributing to the social welfare of surrounding communities. Consistent with the guiding principles of the Cuban revolution, the government could fine-tune fiscal policies of revenues and taxes to pursue a more equitable distribution of income and social services. Indeed, a more productive economy will be required to sustain the government's historic commitment to universal access to quality health care and education. If growth can be accelerated, the Cuban middle classes, having emerged from the masses and educated to an egalitarian ethos, could well support affirmative distribution policies.<sup>58</sup>

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<sup>58</sup> The CEEC seminar in Havana, September 25, 2013, on an earlier draft of this monograph helped to clarify this point.

## 8. Policy Conclusions and Recommendations

**C**ubans will determine their own future but external actors, including the U.S. government and society, can strengthen forces for progress and prosperity and reduce the costs of change and the dangers of political violence and regional instability. Or the U.S. government can stand in the way of progress by ignoring the transformational shifts underway on the island, by denying Cuban entrepreneurs access to capital and markets, and by impeding engagement of the international financial institutions. The following recommendations for the Cuban and U.S. governments are mutually reinforcing and seek a soft landing that will free the Cuban economy from its prolonged stagnation and enter a new period of sustainable economic growth. The recommendations for the Cuban government reflect the voices of the many actual and aspiring entrepreneurs, as well as scholars and other Cuban citizens, who were consulted in the course of this study.

### Recommendations for the Cuban Government

The Cuban government can articulate a clear mission statement with these strategic messages:

- As a long-term development strategy, Cuba will pursue a hybrid market socialism open to the international economy, where a strong state sector both collaborates and competes with the growing private sector, and the island is increasingly integrated into regional Caribbean basin and global supply chains.
- The government will pursue an inclusive model that seeks to advance not only the interests of workers and peasants but also of private entrepreneurs and the middle classes—legitimate outcomes of the revolution.
- The government will implement a series of macroeconomic and sector reforms (although beyond the scope of this monograph) consistent with this broader vision and which will measurably improve the business climate. Especially urgent are measures to fortify the economy against potential negative external shocks, notably a future reduction in the oil subsidies provided by Venezuela. In this regard, the government should engage the

international financial institutions (IFIs), develop an active dialogue between Cuban and IFI experts (and other international economists and social scientists), and once sufficient mutual trust has been established request technical assistance and eventually full membership.<sup>59</sup>

Specifically, to improve the business climate, the Cuban government can:

- Continue to review the tax code so as to encourage taxpayer participation and reliable reporting, and augment tax collection and auditing capacities, thereby strengthening the fiscal regime.
- Remove tax and other disincentives to business expansion, investment, and job creation, such as the upward-sloping tax base that discourages hiring more employees, and jettison arbitrary limits on the sizes of business (e.g., the number of seats in restaurants).
- Revise the restrictions governing business advertisements while protecting the beauty of cityscapes.
- Urgently review regulations regarding the leasing and sale of government-owned retail space.
- Begin to digitalize banking, making it more convenient for businesses to pay taxes, and for both domestic and foreign consumers to use credit and debit cards.

Cuban business suffers from capital scarcity. Mandated to support state-owned enterprises and lacking liquidity, the Cuban financial system will not be able to meet business demand for credit in the short to medium term. Consequently, Cuba should:

- Allow and even facilitate business access to international capital, from small-scale investors, including the Cuban diaspora, as well as from multinational firms seeking to integrate Cuban production into their regional and global supply chains.
- Accept cooperation proposals by experienced partners, such as Brazil, Spain, the European Union, and the Catholic Church, to establish credit and training programs for small businesses and cooperatives. Authorize reputable non-profits with extensive experience in small business development to operate in Cuba.

To enhance the economic contributions of *cuentapropistas* (TCPs), the government can:

- Expand the number of eligible occupations to include professional services and to encourage more lines of manufacturing.
- Build on the pilot Boyeros wholesale produce market to open wholesale markets for a wide range of business supplies.

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<sup>59</sup> For details, see Richard E. Feinberg, *Reaching Out: The New Cuban Economy and the International Response* (Washington, D.C.: Brookings Institution, 2011), Section 4.

- Clarify the regime governing cooperatives to facilitate the legalization of SMEs.
- Expand the scope for SOEs to contract directly with TCPs and cooperatives.
- Allow registered private firms direct access to international commerce.
- Speak out firmly against lingering attitudes that discriminate against TCPs and review the deeply resented inspection regimes governing commerce, to encourage compliance with more reasonable codes of behavior that effectively protect the public interest.

In pursuing equity goals, the government can consider these measures:

- Substitute progressive taxation for quantitative restrictions.
- Mandate responsible business behavior regarding labor, the environment, communities, and consumers, and encourage stakeholder engagement in rule making and compliance. Such regulations would apply equally to domestic and foreign-owned businesses.
- Accelerate the commitment to encourage the formation of urban cooperatives, and create oversight entities to ensure that cooperatives comply with stipulated principles and also to advocate policies supportive of their economic success.<sup>60</sup>
- Expand access to training programs that build business capacity, encouraging women and Afro-Cubans to participate.

## Recommendations for the United States

In addition to the aforementioned possible scenarios—exclusion leading to reform stagnation or inclusion leading to a soft landing—there is a third possibility: sudden regime breakdown and rapid transition (Graph 7.2, page 45). In this scenario, the state security apparatus collapses and civil society rapidly organizes a new regime (in the manner of some Eastern European nations). However, while it cannot be ruled out entirely, in the Cuban case a sudden and rapid transition appears unlikely, in light of the residual legitimacy that the regime enjoys especially among the older population, the hope in the future kindled by the economic reform process, the pervasive and apparently still reliable state security apparatus, and a generalized political passivity and inertia.<sup>61</sup>

Since Fidel Castro's seizure of power, the goal of U.S. sanctions policy, as codified in legislation (the 1992 Cuban Democracy Act, the 1996 "Helms-Burton" Cuban Liberty and Democratic Solidarity Act) has been regime collapse and rapid transition, albeit without success. Within the national

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<sup>60</sup> For additional measures to ensure a fair distribution of the benefits of market-oriented reforms, see Mayra Espina Prieto, "Retos y cambios en la política social," in Pavel Vidal y Omar Everleny Pérez Villanueva (eds.), *Miradas a la economía cubana: El proceso de actualización* (Havana: Editorial Caminos, 2012), pp. 157-172.

<sup>61</sup> In a 2010-2011 survey of 506 persons, Daybel Pañellas of the University of Havana identified a widespread "pobreza motivacional," as reported in "Grupos e identidades en la estructura social cubana," *Temas*, No. 71, July-September, 2012, pp. 74-83.

security bureaucracy of the U.S. executive branch, in contrast, there is a strong preference for a gradual, peaceful evolution in Cuba. While endowed with a superficial appeal, sudden upheaval would entail substantial risks for U.S. interests, including political instability and unpredictable violence, economic decline amidst disorder and uncertainty, social disarray opening space for international criminal syndicates, and in the worst case irresistible pressure for intervention to quell civil strife and halt a mass exodus of refugees. Unguided regime collapse in Havana could become a monumental headache for Washington.

Arguably, an economic soft landing harbors the best chance for peaceful political liberalization. As noted in the author's 2011 monograph, *Reaching Out: Cuba's New Economy and the International Response*:

"While there is no automatic, linear relationship between market-oriented economic reform and political liberalization, political theory and recent history suggest that one trend tends to reinforce the other, especially in the Western Hemisphere and in the long run. Moreover, in the absence of direct leverage over a nation's political institutions, promoting economic reform may be the most realistic option for advancing political pluralism. In Cuba today, the opportunity is in economic policy, legitimized by the regime and openly and widely debated by the Cuban public ..."<sup>62</sup>

**Thus, for reasons of national security and a pragmatic idealism, U.S. policy should abandon the pursuit of regime collapse and instead tilt toward promoting the soft landing scenario.** While the internal dynamics of the hermetic Cuban regime are opaque, the uneven pace of reforms suggests on-going struggles between orthodox Communists and the economic reformers; U.S. policies that strengthen private business in Cuba bolster reform and increase the probabilities of a gradual economic transformation.

**To promote private business in Cuba, the president should authorize U.S. firms and individuals to engage in commerce in goods and services with independent entrepreneurs in Cuba, and to provide financial and technical assistance to them.** U.S. exports would enable Cuban entrepreneurs to access badly needed machinery and other supplies and U.S. creditors would fill the capital gap. U.S. importers would broaden the consumer base for Cuban producers, especially for those engaged in manufacturing and other tradable goods, raising quality standards and firm competitiveness. Selectively licensing trade with Cuba would also serve the president's export

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<sup>62</sup> Feinberg (2011), p. 4.

expansion goals. Hiring talented Cuban professionals at competitive wages would enhance the competitiveness of participating U.S. firms.

The U.S. government should design a procedure to ensure that the partnering Cuban firms are genuinely independent. Two alternatives present themselves:

- A) The U.S. could negotiate with the Cuban government a mechanism to certify private firms in Cuba as eligible for commercial exchange. The Cuban government may balk at an intrusive certification procedure, but it has a strong incentive to gain access to U.S. trade and finance, and the Cuban government would have difficulty explaining to its people why it had refused to authorize a weakening of U.S. economic sanctions. To avoid stationing U.S. government officials on the island, the U.S. and Cuba could agree on a non-governmental organization (NGO), or perhaps a multilateral development institution, to serve as the certification entity, much as U.S. brands contract with NGOs to audit their overseas suppliers. Among its rules, this entity would expect that interested private firms in Cuba be willing to demonstrate their eligibility by sharing records of official registration, annual revenues, and tax compliance. As a healthy by-product, such requirements would encourage Cuban entrepreneurs to join the formal sector. Under Cuban regulations, public officials are permitted to take out TCP licenses, such that GESPI, once formalized, would also be eligible for certification. This procedure could be given a reciprocal character, if the Cuban government wished to pre-certify U.S. firms interested in commercial exchange with the Cuban private sector.
- B) Alternatively, and more simply, U.S. firms could apply to the U.S. government for an export license and make the case that the Cuban commercial partner fits the licensing requirements. This method would follow the precedent set for licensed U.S. travel providers that carry the burden of proof that their trips meet the established educational and cultural eligibility criteria.

**The U.S. government should require, as it is doing for investments in Myanmar, that U.S. firms practice responsible corporate citizenship in Cuba.** For larger transactions in excess of a pre-determined amount, U.S. firms should release information regarding their efforts to assure that their Cuban business partners are upholding internationally recognized labor standards, are taking adequate measures to protect the environment, and are practicing responsible citizenship in their local communities. A bi-national advisory board of U.S. and Cuban stakeholders could oversee this process.

**The U.S. government should engage its many time-tested tools to promote Cuba's emerging private sector and associated middle classes.** Over the years, the United States has developed a large arsenal of policy instruments to promote SMEs in developing countries. These include

programs within the U.S. Agency for International Development, the Millennium Challenge Corporation, the Export-Import Bank, the Overseas Private Investment Corporation, and the Small Business Administration (including its Global Partnership with the U.S. Department of State), and in multilateral institutions, the World Bank Group including the private-sector oriented International Finance Corporation, and the Inter-American Development Bank and its small-business oriented Multilateral Investment Fund. The U.S. should treat Cuba normally—as it would other developing countries, including those with authoritarian political systems—and consider the usefulness of these programs in the Cuban case. In doing so, the U.S. should take care to frame these programs—as U.S. diplomats instinctively do worldwide—as being supportive of the partner’s goals of building a more dynamic and prosperous national economy. The U.S. should coordinate its policies with other interested nations, including Brazil, Canada, Mexico, and Spain, and the European Union, some of whom already have relevant initiatives on the island.

As a first step, the U.S. government could facilitate visits by groups of Cuban business owners to engage with their counterparts in the United States, to experience state-of-the-art practices and to build business partnerships.

Currently, U.S. regulations deny even licensed U.S. travelers to Cuba access to certain financial services including use of their credit and debit cards issued by U.S. banks. If these prohibitions were lifted and U.S. visitors were allowed access to electronic payment systems, they could more easily purchase the goods and services produced by the island’s private entrepreneurs and non-state cooperatives.

According to legal authorities, such measures are within the power of the President and are consistent with Congressional legislation seeking to promote a more prosperous and freer Cuba.<sup>63</sup> If properly framed, such initiatives would demonstrate the strategic vision and creativity of U.S. foreign policy, nimbly taking advantages of opportunities as they arise in rapidly evolving circumstances. In addition to appealing to basic U.S. values supportive of freer markets and private initiative, such measures would be well received in Latin America, where U.S. diplomacy is under pressure to respond to the changes underway in Cuba.

In conclusion, Cuba is undergoing its most profound changes since the early 1960s, but the outcome is uncertain and several scenarios are imaginable. The stakes are high for Cubans and for the United States. The U.S. has abundant opportunities to play a constructive role, particularly if it can coordinate with other regional and global players. But the U.S. forfeits its leverage if it stands on the sidelines, hamstrung by domestic political wrangling or distracted by apparently more pressing

crises. Yet, in a turbulent world where events are often beyond the reach of Washington, in nearby Cuba, which remains relatively peaceful and stable, an historic opportunity beckons.

FIGURE 8.1. INDEPENDENT MERCHANT AT PRODUCE WHOLESALE MARKET, HAVANA





**Annex:** Authorized categories within which Cubans can now seek licenses (in most cases from municipal authorities) for self-employment (trabajo por cuenta propia), as of September 26, 2013.<sup>63</sup>

1. Musical Instrument Tuning and Repair
2. Water Delivery
3. Construction Laborer
4. Animal Rental
5. Formal Wear Rental
6. Knife Grinder
7. Party Entertainer (clowns, magicians)
8. Mule Driver
9. Artisan (arts and crafts maker)
10. Mechanical Saw Operator (as in a sawmill)
11. Babysitter/Nanny
12. Barber
13. Embroiderer/Knitter
14. Wagon or Pushcart Operator (to help move things)
15. Flower Bed Arranger
16. Carpenter
17. Mobile Hand Cart Hawker of Agricultural Products
18. Locksmith
19. Furniture Repairman
20. Collector and Payer of Bills
21. Operator of Children's Fun Wagon Pulled by Pony or Goat
22. Buyer and Seller of Records (including CDs)
23. Used Book Seller
24. Builder/Seller/Installer of Radio and TV Antennas
25. Craftsman/Seller/Repairman of Wicker Furniture
26. Breeder/Seller of Pets
27. Window Glass Repair
28. Animal Caretaker
29. Public Bathroom Attendant
30. Caretaker of Elderly/Handicapped
31. Public Park Caretaker
32. Leather Tanner (except cows and horses)
33. Decorator
34. Palm Tree Trimmer
35. Restaurant Owner (paladares)
36. Café Owner (cafetería)
37. Non-Alcoholic Beverage Seller (home delivery)
38. Café Owner (cafeteria, light snacks and beverages)
39. Street-based Seller of Food and Beverages
40. Charcoal Manufacturer/Seller
41. Wine Maker/Seller
42. Maker of Yokes, Harnesses and Rope for Oxen
43. Electrician
44. Automobile Electrician
45. Building Superintendent

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<sup>63</sup> Source: Gaceta Oficial, No. 027, Special Edition, Resolution 42/2013, September 26, 2013, Annex; and Associated Press, "List of 178 Cuban private-sector jobs," January 30, 2011. Activities 170-187 are authorized by the Office of the Historian of the City of Havana ("Havana Vieja" or "Old Havana").

46. Book Binding
47. Electric Motor Rewiring
48. Animal Trainer
49. Flower Wreath Arranger
50. Button Coverer (wraps buttons in cloth, popular in the 50's and 60's)
51. Photographer
52. Car washer/Oil Changer
53. Bus/Train/Taxi Stop Barker (calls out instructions to waiting passengers)
54. Engraver of Numbers
55. Blacksmith/Seller of Horseshoes and Nails
56. Trader of Scrap Metals
57. Driving Instructor
58. Sports Trainer (except martial arts and diving)
59. Gardener
60. Clothes Washing/Ironing
61. Woodsmen/Logger
62. Shining Shoes
63. Spark Plug Cleaner and Tester
64. Septic Tank Repairman and Cleaner
65. Manicurist
66. Make-up Artist
67. Masseuse
68. Plasterer
69. Refrigerator Mechanic
70. Typist and Copier
71. Messenger
72. Seamstress/Tailor
73. Miller of Grains
74. Audio Systems Installer/Operator
75. Tire Repair
76. Children's Ride Operator
77. Parking Attendant (including for cars, bicycles)
78. Hairdresser
79. Animal Groomer
80. Cleaning/Household Help
81. Car Painter
82. Furniture Painter and Polisher
83. House Painter
84. Sign Painter
85. Ornamental Fish Farmer
86. Plastic Covering Maker for IDs
87. Plumber
88. Well Digger
89. Producer/Seller of Items Used in the Home (self-made or made by other self-employed)
90. Producer/Seller of Rubber Accessories
91. Producer/Seller of Clay Goods (pots, planters, cookware)
92. Producer/Seller of Bricks and Tiles
93. Producer/Seller of Articles and Animals for Religious Use
94. Producer/Seller of Harnesses, Blankets, and Saddles
95. Producer/Seller of Costume Jewelry
96. Shoemaker/Shoe Salesman
97. Producer/Seller of Brooms and Brushes
98. Producer/Seller of Plaster Figurines
99. Grower/Seller of Ornamental Plants
100. Piñata Maker/Seller
101. Grower/Seller of Plants for Animal Feed and Medicinal Purposes
102. Music/Art Instructor

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|---|--|
| 103. Shorthand, Typing, and Language Instructor               | 132. Leather Craftsman                                 |
| 104. Computer Programmer                                      | 133. Upholsterer                                       |
| 105. Metal Polisher   | 134. Roofer  |
| 106. Collector/Seller of Natural Resources (i.e. sell shells) | 135. Accountant/Tax Preparation                        |
| 107. Collector/Seller of Recyclables                          | 136. Textile Dyer                                      |
| 108. Watch Repair   | 137. Machinist   |
| 109. Leather Repair   | 138. Roaster (i.e. of peanuts, coffee)                 |
| 110. Jewelry Repair   | 139. Part-time Farm Laborer                            |
| 111. Bedframe Repair  | 140. Document Translator                               |
| 112. Automobile Battery Repair                                | 141. Shearer (as in sheep)                             |
| 113. Bicycle Repair   | 142. Thresher  |
| 114. Costume Jewelry Repair                                   | 143. Vegetable/Fruit Street Vendor (from fixed venues) |
| 115. Fence and Walkway Repair                                 | 144. Shoe Repair                                       |
| 116. Stove/Range Repair                                       | 145. Contracted Employee of a Self-Employed            |
| 117. Mattress Repair  | 146. Event Planner (weddings, etc.)                    |
| 118. Small Household Goods Repair                             | 147. Mason   |
| 119. Office Equipment Repair                                  | 148. Real Estate Broker                                |
| 120. Electronic Equipment Repair                              | 149. Repair of Measurement Instruments                 |
| 121. Mechanical and Combustion Equipment Repair               | 150. Food Wholesaler                                   |
| 122. Eyeglass Repair  | 151. Food Retailer (in kiosks and farmers' markets)    |
| 123. Sewing Machine Repair                                    | 152. Room/Home Rental                                  |
| 124. Saddle and Harness Repair                                | 153. Postal Agent                                      |
| 125. Umbrella and Parasol Repair                              | 154. Telecommunications Agent (retail)                 |
| 126. Disposable Lighter Repair and Refill                     | 155. Building Construction Services                    |
| 127. Tutor (currently employed teachers not eligible)         | 156. Car Body Remolding                                |
| 128. Doll and Toy Repair                                      | 157. Maker/Seller of Marble Objects                    |
| 129. Art Restorer   | 158. Maker/Seller of Soaps, Dyes                       |
| 130. Night Watchman or Building Doorman                       | 159. Welder  |
| 131. Welder   | 160. Iron Worker (grating for doors, windows)          |
|   | 161. Welder/Flamecutter (cutting with gas)             |

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| 162. Maker/Seller of Aluminum Products                          | 181. Fresh Fruit Peeler                          |
| 163. Maker/Seller of Non-Ferrous Metals                         | 182. Dance Duo "Amor" (traditional Cuban dances) |
| 164. Floor Polisher   | 183. Benny Moré Dance Team                       |
| 165. Repairer of Water Pumps                                    | 184. Trained Dog Exhibitor                       |
| 166. Space Rentals in One's Home to Self-employed               | 185. Musical Duo "Los Amigos" (popular music)    |
| 167. Insurance Agent  | 186. Extras (people in period dress)             |
| 168. Maker/Seller of Food and Beverages in "China Town"         | 187. Traditional Barber                          |
| 169. Private Construction Contractor (in the Havana "Old Town") | 188. Truck Driver                                |
| 170. Horse and Carriage Rides                                   | 189. Station Wagon Driver                        |
| 171. Antique Dealer   | 190. Small-Truck Driver                          |
| 172. Habaneras (women posing in colorful colonial attire)       | 191. Bus Driver                                  |
| 173. Fortune Tellers  | 192. Mini-Bus Driver                             |
| 174. Folkloric Dancers  | 193. Taxi Driver                                 |
| 175. Mambises-style Musical Groups (traditional Cuban music)    | 194. Handcar Operator (on rails)                 |
| 176. Caricaturists  | 195. Jeep Driver                                 |
| 177. Artificial Flowers Seller                                  | 196. Passenger Boat Operator                     |
| 178. Painters (who sell pictures in the street)                 | 197. Motorcycle Driver                           |
| 179. Dandy (man dressed in Colonial garb)                       | 198. Three-Wheeled Pedal Taxi Driver             |
| 180. Hair Braider   | 199. Cart Operator                               |
|   | 200. Horse-Drawn Carriage Operator               |
|   | 201. Pedal Taxi Driver                           |

## About the Author

**RICHARD E. FEINBERG** is a nonresident senior fellow with the Latin America Initiative at the Brookings Institution. He is a professor of international political economy at the School of International Relations and Pacific Studies, University of California, San Diego. His four decades of engagement with inter-American relations spans government service (in the White House, Department of State, and U.S. Treasury), numerous Washington, D.C.-based public policy institutes, the Peace Corps (Chile), and now in academia. He is also the book reviewer for the Western Hemisphere section of *Foreign Affairs* magazine.

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