

## THE POST FIDEL TRANSITION: MITIGATING THE INEVITABLE DISASTER

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Eventually the economic regime in Cuba will fall. It will have to wait until Fidel Castro leaves the scene, but then the economic regime, and most likely the political regime, will fall quickly. The world, and especially the United States, must be ready for that time. It is the contention of this paper that the economic transition is likely to be very difficult, perhaps more difficult than many realize. In the first few years, it is more likely to resemble the Russian experience than Poland's, although in the end it will be uniquely Cuban. Changes are likely to come quickly. Policy choices will affect the nature of the Cuban economy for years to come. Cubans in Cuba will make those choices, but they will not operate in a vacuum. Donors, investors, and the Cuban-American community will be influential in many of those decisions. It is important that the issues that will frame those decisions be properly defined. The purpose of this paper is to identify some of the issues.

Two years ago I presented a paper on reforms that already occurred in Cuba.<sup>2</sup> My point was to recognize that reforms had indeed taken place, but that progress had stopped far too soon. Although I mentioned it at the time, in retrospect I do not believe I gave enough attention to how little impact those reforms would have on the post-Fidel transition. The introduction of farmers' markets, the legitimization

of a few small businesses, and the effort to perfect the state enterprises have all served to introduce the concept of markets and market prices to Cubans. These measures have gone a long way to further discredit the socialist system. The creation of a tourist industry has also brought a small but significant number of people—mostly young people—into something close to a modern economy and introduced the concept of service and productive labor. That is about it for the positive, however.

The other reforms, although they may have helped the current economy, will do little for the future. Government ministries, unwilling to give up control, have limited the reform of the state firms. Those firms will not survive the transition, except as holders of valuable real estate and badly depreciated assets. The Cuban Government has introduced budget reforms, which have helped control inflation. They depend, however, on a different system of expenditure and resource accumulation than will exist in a market-based economy. Aside from the farmers' markets, there has been no significant reform in the agriculture sector. The social safety net, while still very important to the average Cuban, has badly deteriorated. It will likely leave more a legacy of expectations than relief to a new government. Foreign investment has been surprisingly modest—partly due to a lack of

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1. The author thanks Ricardo Martínez for his helpful comments. The contents of this paper are the sole responsibility of the author and do not necessarily represent the views of the United States Government or the Department of State.

2. Maybarduk, Gary H., "Measures Not Taken: Issues for Today and Tomorrow." In *Cuba in Transition—Volume 9* (Washington: Association for the Study of the Cuban Economy, 1999).

profitable opportunities and partially due to the Cuban policy of limiting foreign investment to a few very specific areas. Foreign investors complain that much of the labor force between the ages of 30 and 50 simply do not have the attitudes needed by a profit-maximizing firm.

Cuba, of course, will have some very important advantages. A supportive Cuban-American community will supply considerable financial aid to families wishing to reconstruct homes or start businesses. Many Cuban-Americans will want to start their own businesses in Cuba. They will push the U.S. Government to support the transition effort with significant resources, an effort many other donors—both bilateral and multi-lateral—will join. The American business community, intrigued by Cuba, will be anxious to investigate possible investments. An early tourist boom—provided the transition is peaceful—will provide significant revenue for the new government. Hotel space will be limited, but prices will be high.<sup>3</sup> Entrepreneurs will find a well-educated labor force, although with somewhat dated skills and as noted previously with some attitude problems.

To these advantages let us add the best possible scenario for the transition. We will assume it will be peaceful. We will assume that the new government will be committed to economic reform, and will try to follow intelligent macroeconomic policies that discourage inflation, protectionism, or overvalued exchange rates. Let us assume further that it wants to privatize state industries as soon as possible, that it is willing to recognize that confiscated properties need to be compensated, and is eager for foreign investment.

It is highly unlikely that all these assumptions will hold. The political transition is likely to be turbulent

and essential political forces will have divergent views on economic policy. Nevertheless, even with this rosy scenario, the transition will be very difficult. There are major structural problems in the Cuban economy that cannot be corrected overnight. Simply changing the ownership of production and the freeing of prices cannot solve them. Management of these problems will require careful planning. For many of these reforms, the starting point will be critical. Once movement along a path begins, it will gather its own rationale and interest groups. It may be very hard to change direction. Mistakes could be very costly in terms of growth, employment, and social stability. Early and careful consideration of policy options is essential.

### THE SUGAR INDUSTRY

The problem is apparent in the sugar industry, which still employs at least 400,000 people.<sup>4</sup> Somewhere between one to two million people are dependent on the sugar industry, between 10-20 percent of the Cuban population. The industry, as presently organized, is not profitable. Even if privatized, it is unlikely to be profitable without enormous investment in new mills, and new agricultural and transport equipment. Given depressed world sugar prices, it is not evident how many of Cuba's sugar plantations will ever be profitable.

Even if there is a potential for profit, however, it is likely to depend on how the industry is organized. There will be some pressure to return the plantations to their original owners. That will keep the production units together—at least initially—and solve at least a small set of the compensation problems. I am not sure, however, that such a solution will be acceptable in a post-revolutionary Cuba. It will quickly

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3. As explained to the author by the foreign managers of several hotels, the Cuban government holds majority ownership in most hotels, including those recently constructed. Generally, the foreign corporations that manage the major hotels hold only a small equity ownership, although they may lend the government part of the capital necessary for construction. Repayment comes out of hotel revenues. If there is a tourist boom during the transition, a shortage of hotel space should allow for high prices and profits. If the industry is privatized, these hotels should earn a large premium because they are already established and they often sit on prime land.

4. Radio Rebelde, "Straight Talk," March 18, 1998. According to another source, only 300,000 work directly in the industry, with an additional million working in related industries. The discrepancy may come from the inclusion or exclusion of refinery and transport workers. "Esperanzados en recuperación del azúcar," *Economics Press Service*, Año 11, No 24 (December 31, 1999).

lose legitimacy if large layoffs or closures follow such privatization, as seems inevitable.

A similar problem exists with selling the sugar plantations to foreign investors. It might ensure that the buyers have the capital to rebuild the plantations, but the political difficulty of the “latifundia” would remain. It is also likely that many of the sugar estates simply would not find buyers, especially if they were required to continue as sugar plantations.

Politically, it might be more acceptable to sell only the sugar mills and distribute the land to individual farmers. However, unless carefully designed, such an approach could doom any sugar production. My own observation, from visiting sugar plantations in many countries, is that they tend to concentrate the fields around the refinery. One notices in Cuba that this is often not the case. Perhaps as a heritage of the Soviet free-oil deals, the fields are often widely scattered, with food crops or pastures between the sugar fields and the refinery. With the high cost of fuel, this can substantially raise production costs. Should the distribution of land to the workers require that they in turn produce sugar for the mill? Does individual profit maximization in this case lead to a Pareto optimal solution, especially if the social costs of unemployment are included?<sup>5</sup>

If the mills are closed what happens to the labor force? Much of the labor force on the sugar plantations is actually rural labor, not farmers. They are not necessarily prepared to farm and may not want to be farmers. The market solution, of course, is to allow those who do not want or cannot be farmers to sell their land rights to those who wish to farm it. The trouble with moving away from sugar production is that initially it is likely to reduce the number of jobs available. During my stay in Cuba, a government economist told me there had been numerous Cuban government studies indicating that almost any use of the land, especially cattle raising, but also other food crops, would be more profitable than sugar. He claimed, however, that the employment consequences would be so severe the government dared not take the risk.<sup>6</sup> These problems will also be real for a new government, especially if there is no social safety net in place and until alternative employment becomes readily available.

The problem on state farms is similar. The basic unit of production cooperatives (UBPCs), state farms, and agricultural cooperatives have close to 400,000 employees or members according to 1993 figures.<sup>7</sup> This work force should have more success than that of the sugar industry in shifting into private farming. Nevertheless, the problem is only a matter of degree

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5. For the economist, there are several formulations of the problems. At one level, it is the recognition that different divisions of land ownership result in changes in output composition. The problem is finding a distribution that maximizes income (and/or employment) in a politically acceptable manner. A more precise formulation would assume: (1) that sugar production enjoys considerable economies of scale and that the degree of concentration around the mill is a factor in the production function and therefore in profit maximization; (2) that given centralized direction from the sugar mill, the sugar production functions of individual farmers are identical; and (3) that the production functions for other agricultural crops could differ greatly among individual farmers. Under such assumptions, one would search for a Pareto optimal distribution of land that would maximize total farm incomes. A Pareto optimal solution is one that in theory at least those farmers that might have fared better under alternative land distributions could be compensated so that at a minimum they would be no worse off under the optimal solution. For the political scientist, the question is what types of land distribution will be politically acceptable in a democratic Cuba.

6. Many Cubans also argue there are severe social problems in shutting down the mills. They argue that the sugar industry is as much a culture as an occupation with many families having spent several generations on the plantations. The Cuban Government has closed a large number of mills in recent years, but appears to have continued field production and shipped the cane to distant mills, perhaps to avoid just such disruption.

7. Calculated by taking the 400,000 estimate of the number of sugar workers and subtracting it from the 1993 figure of 846,000 employees in agriculture. Some adjustment would have to be made for private farmers, including tobacco growers, to make the number more exact, but given the changes since 1993, any estimate is likely to have a wide margin of error.

and again a very large number of people are involved.<sup>8</sup>

There will also be major problems of land division on the cooperatives. They were often formed from private farms that were forced into larger organizations. Questions of original ownership and the division of assets could slow privatization.

### CONFISCATED PROPERTY AND PROPERTY TITLES

The magnitude of the challenges posed by agriculture is matched by the problem of property titles. In the initial stages of the transition there is likely to be a rapid increase in small retail establishments as people convert their homes and state corporations rent out space in their buildings. Very quickly, however, those that want to make sizable and permanent investments are going to run into a serious roadblock. They will be unable to obtain a clear property title.

Property titles are likely to be a more difficult issue in Cuba than in any other transition from a socialist economy. I can think of no other nationality that in exile has maintained such an emotional tie to their former home and such anger—understandable anger—at what has happened to them and their country. The exile community will be one of the greatest assets to a successful transition. At the same time, that community will understandably require recognition of their claims to the property taken from them. The total number of confiscated properties is likely to be huge and encompass much of the productive property throughout Cuba.<sup>9</sup> It includes potentially very valuable property such as apartments on the Malecón, to factories and retail establishments, and homes and farms. The claims will also

come from many who still live in Cuba, especially those who owned farms and were forced into cooperatives and collectives. Many claimants will not have proof of ownership or perhaps not even be able to find their properties. Public records are likely to be incomplete, if they exist at all.

Many claimants will want their property back if only for emotional reasons. Others will want to restart family businesses. They will resent Cuban government or ex-government officials who have taken over the nicer or more valuable houses. Cubans who live in houses and apartments will claim that these units have become their homes. They will rightly point out that although the Cuban population has doubled since the revolution, there has been nowhere near that much new construction. However humble or rundown their home, there is simply no other place to live. If officials from the current government emulate their Sandinista colleagues and grant themselves piñatas, the situation will be even more confused and acrimonious.

The Cuban situation is not, of course, unique. Similar situations presented themselves in Eastern Europe and Nicaragua. I have not studied Eastern Europe, but I have spent considerable time on the property problem in Nicaragua. In Nicaragua, the policy is to decide restitution or compensation questions on a case by case basis, albeit with general rules that protect occupants of most homes and small farmers who took over large estates. The problem with the Nicaraguan model is that after 10 years, thousands of cases remain unsettled, and the slowness in resolving claims has been major factor in the slow economic recovery following the establishment of democratic

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8. Coincident with the creation of farmers' markets has been increased production of domestic food crops, suggesting that the non-sugar agricultural sector can respond to market incentives. Unfortunately, the available data do not separate state farms and UBPCs from private farmers and cooperatives. UBPCs, however, sell part of their produce in the farmers' markets. See Naciones Unidas, Comisión Económica para América Latina y el Caribe, "Cuba: Evolución Económica Durante 2000" (Mexico July 13, 2001). There is also some evidence that some UBPCs may have permitted the creation of individual farmer's plots on the cooperatives' land. See *Trabajadores* (October 1, 2001).

9. Travieso-Díaz and Ferraté have argued it is in the hundreds of thousands. Their article provides an excellent review of many of the current legal arrangements for foreign investment and the legal issues in privatization. Matías F. Travieso-Díaz and Alejandro Ferraté, "Legal Foundations for a Successful Privatization Program in Cuba." In *Cuba Transition Workshop—Internal and External Factors in Cuba's Economic Transition* (Washington, D.C.: Shaw Pittman, Potts & Trowbridge and the Association for the Study of the Cuban Economy, March 25, 1999).

government.<sup>10</sup> The lack of titles makes investment difficult, prevents sale and development of property, and substantially raises the transaction costs of those investments that do take place. In Cuba the situation will be much more difficult. Proportionately the taking of property was much greater. In the agricultural sector the takeover was almost total.

Sorting out property cases has been a problem in most ex-socialist countries, but in Cuba—perhaps more than any other economy in transition—the need to move quickly will be imperative. Justice to the owners will be hard to achieve, but the danger of the case-by-case approach is that it will do serious injustice to Cubans in Cuba who will be looking for and deserve rapid economic growth. Separating the decision as to who gains title from the question of compensation may provide a solution. At a minimum any solution must give high priority to establishing property titles.

#### THE SOCIAL SAFETY NET

The Cuban social safety net has declined considerably since the withdrawal of Soviet assistance. Despite its much-reduced state, it is still very important to many Cubans, whose average monthly wage is less than fifteen dollars. The security of having one's own residence, the provision of free education, free health care, and a ration card that provides food for 7-10 days per month, are viewed as basic rights by most Cubans. Its maintenance during the transition will be important to maintaining social stability. Cubans understandably will be uncertain and fearful of entering competitive markets. The maintenance of the social safety net will provide some security during this period and could ease the transition. With the arrival of the transition, the reality of Cuba's social problems will become more apparent, and the demands on the social safety net will increase. I strongly suspect that we are going to find that Cuba's health conditions are much worse than indicated by Cuban figures, especially among the elderly.

The problem of maintaining the social safety net, of course, is paying for it. Currently, the safety net is largely financed by confiscation of labor and goods through the Government's ability to set prices. With the move to a free market system, the ability to finance that safety net—at least initially—is likely to diminish. Price changes can work both ways, of course, and the government may be able to reduce subsidies to the non-sugar industries, especially in agriculture. However, in the tumult that will exist in the transition period, the government is likely to have a difficult time financing its basic services, much less an extensive social safety net. As a rough indicator of the problem, Cuban budget expenditures in 1997 were 54 percent of GDP. In the same year, Brazilian budget expenditures were 14 percent of GDP.<sup>11</sup>

The problem is likely to have important implications for donors of economic assistance during this period. My big fear is that we are likely to try to do too much with our assistance and under-fund crucial activities.

#### MIGRATION AND EMPLOYMENT

Migration to Havana and perhaps a few other big cities is likely to become a major problem during the transition. According to official statistics, in 1996, 2.8 million Cubans (25 percent of the population) lived in rural areas, but Cuba is a country of numerous small cities, which gives it a feeling of being even more rural. Driving through those cities gives one a sense of nothing happening and nothing to do. When controls on movement are lifted, there is likely to be a major move to the excitement of the big cities. The same statistical source reports 842,000 persons in agriculture, which does not appear to include agriculture-related industries. I started with the farm problem because it leads to a whole series of other problems. The closure of sugar mills without alternative employment is also likely to lead to considerable migration. Tourism, often viewed as Cuba's great hope, will provide some employment, especially since

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10. Conversation with Tim Stater, Economic Counselor, American Embassy Nicaragua (July 25, 2001).

11. Maybarduk, Gary H. "Measures Not Taken: Issues for Today and Tomorrow" In *Cuba in Transition—Volume 9* (Washington: Association for the Study of the Cuban Economy, 1999, p 288)

the beaches are often located in rural areas. However, in 1998 tourism only employed 80,000 people.<sup>12</sup> Until there is a major expansion of tourist facilities, and we again return to the property title problem, expansion is going to be difficult. Even a doubling or tripling of employment in the tourist industry is not likely to replace the jobs lost in sugar, much less in other agricultural industries.

### CRIME

In the transitional period, crime is likely to provide serious challenges to Cuban society and to the United States. If popular news accounts are correct, crime has been an enormous problem in post-Soviet Russia. It was, of course, a major problem in pre-Castro Cuba. Today economic crime is endemic throughout Cuban society, with close to 100 percent participation by the Cuban population.

It is simply not possible to live in Cuba without dealing in the black market. To compensate for impossibly small incomes, most people either sell services, goods stolen from a state farm or factory, or illegal agricultural produce—grown or raised by the seller or a close contact. Virtually everyone must buy from the black market to meet their basic needs, be it meat, eggs, fish, or clothing. The universality of this illegal activity has stripped from it any social or ethical stigma, a situation that could take a couple of generations to overcome. Add to this mixture widespread prostitution, which at times the State has used to encourage foreign tourism, and one begins to have some sense of the difficulty of the problems to come. To date, the police state keeps crime under some control. When the policeman on every corner disappears, however, the situation may become even worse.

The implications for the United States are also important. Cuba is, of course, only a few miles off the Florida coast. Drug smuggling, once encouraged by some Cuban officials, continues off the Cuban coast.

Unfortunately, we are not going to be able to avoid the crime issue, but good economic policies can diminish it. The proper handling of the issues discussed above—the future of the sugar and agricultural industries, property titles, and the social safety net—will not only make the transition easier, but also diminish crime inside and outside Cuba. Making the transition successful is just as important for the U.S. national interest as it is for our humanitarian concerns for the people of Cuba.

### OTHER ISSUES

I have limited my comments in this paper to a relatively few issues. This is partially in order to keep the presentation to a reasonable length and partially because some of the other issues have been discussed at greater length at previous ASCE meetings.<sup>13</sup> Appropriate macroeconomic policies, the choice of an exchange rate regime, and governmental accountability are very important issues, and if mishandled will seriously slow recovery. Fortunately, recognized institutions like the IMF will be available to provide guidance and arbitrate differences on macro-economic policies. The issues discussed in this paper, however, are more likely to be highly controversial, often emotional, and will lack the recognized institutions to arbitrate differences.

### INFLUENCING THE TRANSITION

The economic policy-making process in post-Fidel Cuba will be very difficult. In the end, it will be the responsibility of the new Cuban government. Nevertheless, the donor nations, of which the United States will be the largest, will likely exert influence. The United States will be joined by the multilateral institutions and foreign investors. Unfortunately, many of these institutions will be poorly positioned to provide such advice, especially in the compressed time that many of the decisions will require.

I am very fond of my own institution, the Department of State, but as an organization we are not well

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12. "Income increases for 10<sup>th</sup> consecutive year," *Granma International* (March 1999).

13. See for example: Arne C. Kildegaard and Roberto Orro Fernández, "Dollarization in Cuba and Implications for the Future Transition"; Mark Gallagher, "Some Ideas for Taxation during Cuba's Transition"; and Jorge A. Sanguinety, "Macroeconomic Policy Issues for a Free-Market Cuba," all in *Cuba in Transition—Volume 9* (Washington: Association for the Study of the Cuban Economy, 1999).

suited to study these issues in great detail and then retain the information over long periods. The U.S. Agency for International Development (USAID) is better suited for such a role, but Congressional mandates and interventions make it difficult for it to focus its efforts. As I have already noted, the IMF will be able to play an important role in macroeconomic policy issues, but is not qualified to address the issues discussed in this paper. The World Bank and the Inter-American Development Bank may eventually play a role, but Cuba is not a member of either and these institutions tend to move slowly.

The Cuban-American community, whose members may become the largest source of investment capital and entrepreneurship, will try to fill this policy vacuum. It will influence events in Cuba both directly and through its influence on U.S. policy. This in turn leaves a major role for ASCE.

### THE ROLE OF ASCE

ASCE can be proud that it has taken the lead in the discussion of transition issues. The title of our annual proceedings is indicative of the emphasis the transition has received. That said, I think we can do more. My 1999 papers focused on the post-Soviet era transition in Cuba. Only at the end did I discuss the issues facing the post-Fidel transition. In this paper, I have focused on the latter issues and, judging from the other papers presented at this meeting, ASCE is making that move as well. (Any efforts at additional economic transition in Cuba effectively had ended by 1995.)

We need careful studies of the likely demand for Cuban sugar and the possibility that at least some of the sugar plantations can be profitable. We need to look at the organization of sugar mills worldwide to be able to draw on examples of what is likely to work in Cuba. These studies should pay careful attention to the forms of land ownership. Alternative uses for this

land and policies that stimulate investment in rural areas and small cities would be very useful.

My own view is that there is a profitable future for much of non-sugar agriculture. However, we need more prescriptive agricultural-organization studies of privatization. The varied nature of these farms, their internal organizations, and the method by which they were collectivized or turned into cooperatives will affect their divestiture.

Compensation for confiscated property has long been a theme for many ASCE papers. I particularly liked G. Douglas Harper's 1999 paper comparing Eastern European experience and restitution versus compensation models.<sup>14</sup> Nevertheless, I think we can do a lot more. Specifically I would like to see a greater emphasis on the quick granting of titles so that the issue does not hinder investment.

Again, the Eastern European experience with the social safety net will be very interesting to study. My intuition tells me that the collapse of the Soviet safety net has been a major factor in resistance to change, especially on the state farms. However, careful studies might give us hard information on this and other factors that hinder reform. We should look at appropriate tax systems for the transition period, the potential for revenue from privatization, and very importantly, we should discuss how to set priorities for economic assistance.

I stress the latter because the demand for assistance will be enormous. Numerous groups will push their particular and generally worthy causes. They will seek financing to foster democratic institutions, to improve criminal justice systems, to improve public finances, to stimulate entrepreneurship, to encourage micro-enterprise, to support women's rights, and to support the budget. There will be a danger of spreading foreign assistance too thin, leaving the most im-

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14. Harper distinguishes between restitution models where the state returns the property to the original owners and compensation models where the state compensates the owners. At the risk of over simplifying Harper's well-developed arguments, he recommends the restitution model for commercial property because he believes the original owners are likely to take the lead in investing in the economy. For residential property, he recommends compensation to maintain social stability. Harper does not discuss agricultural property. See Harper, G. Douglas, "Restitution of Property in Cuba: Lessons Learned from Eastern Europe." In *Cuba in Transition—Volume 9* (Washington: Association for the Study of the Cuban Economy, 1999).

portant priorities under-funded. My own inclination would be to give high priority to the social safety net, but my purpose in this paper is not so much to push one cause as to encourage discussion. Donors and the new Cuban Government will need to address foreign assistance priorities very early in the transition process. Events at the time will clearly affect priorities, but if the issues are already well defined, the chances of making the right decisions will increase.

ASCE members need to address these issues directly with a clear focus on both the economics and politics of the likely transition. In the terms of our profession, our studies need to have a much greater general equilibrium focus.

And that leads to my final point. As we debate and discuss these issues, it is not enough to limit our discussions to this forum and to the publishing of our papers. We need to bring these policy questions to the public and especially to the Cuban-American

community. Our role should not be to promote specific policies, but rather to encourage informed public discussion of the issues. We will have been successful if, when the transition begins, those who will have the ability to influence the policy decisions will understand the alternatives and their consequences. We should consider holding special conferences on the important issues and seek greater publicity for our proceedings. We need to take the lead in encouraging public and private research and public symposiums on the issues.

ASCE has a unique and important role to play in Cuba's transition to a free and prosperous nation. No matter how great the problems will be for Cubans, the transition will lead to a better life for the great majority. However, the problems will be great and the spillover to the United States could be serious. If we can help shape the early choices we should be able to make it easier.