

Cuba's 'Structural' Reforms: After a Few Years, Time Can Tell*

Roger R. Betancourt
Professor of Economics
University of Maryland
College Pk. MD 20742

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Author: Roger R. Betancourt, Professor of Economics

Affiliation: University of Maryland, College Park

Abstract:

On April of 2011 a number of seemingly substantial reforms were approved at the 6th Congress of the Cuban Communist Party as well as Raul Castro's official nomination as First Secretary of the Cuban Communist Party. The economic reforms were initially viewed with a varying degree of optimism by a range of observers. Cautiously optimistic ones labeled nine of the economic reforms 'structural' (Mesa-Lago and Perez-Lopez 2013). On April of 2018 The National Assembly voted Miguel Diaz-Canel as President of the State Council, fulfilling one of the proposed political reforms approved in 2011 in a literal sense. Doubts remain about its meaning, since Raul Castro retained his role as First Secretary of the Communist Party and Chief of the Armed Forces. In any event, it is widely acknowledged by all parties that fixing the economy is a most important aspect of the new President's job. In this essay we evaluate progress on fundamental economic reforms, a slightly extended set of the structural ones, since their announcement in 2011 and the likelihood of further progress under Diaz-Canel.

Key words: fundamental reforms; relational contracts; market liberalizations; political economy of reforms; performance of reforms.

JEL Classification: P21; P26; P27; P31; P33; P51

In earlier work (Betancourt 2015), I developed a perspective relying on a variety of ideas stemming from both political economy and the new institutional economics to provide an initial evaluation of Cuba's economic reforms, which were officially adopted at the 6th Party Congress in 2011. The approach was extremely useful as a conceptual and organizational device. It can be applied to evaluate any set of extensive changes in relations within an economic system accompanied by similar changes, or lack of, in governance arrangements. The evaluation focused on a slightly extended version of what Cuban scholars classified as 'structural' reforms (Mesa-Lago and Pérez-López 2013: Table 6.1). It was somewhat limited in evaluating actual effectiveness of the reforms because only three years had elapsed at the time of the writing from official adoption. Thus, one could argue it was not sufficient time for full implementation and, thus, evaluation of truly fundamental reforms.

We are now more than 7 years away from official adoption of the reforms. Hence, sufficient time has passed for implementation and evaluation of fundamental economic reforms. It remains convenient to group the nine reforms labelled as 'structural' into three types. In addition, a few changes that can be viewed as fundamental reforms, not explicitly listed by Mesa-Lago and Pérez-López (ML-PL) as structural, are assigned to their type.

Political economy aspects of two macro reforms listed by ML-PL are the first type to be considered, i.e., exchange rate unification and tax reform. A second type includes reforms associated with updating of the economic 'model' that can be viewed as aspects of relational contracts broadly interpreted. They include the end of rationing system, dismissal of state workers and creation of private jobs through self-employment and cooperatives. To these I would add foreign direct investment, *perfeccionamiento empresarial* (enterprise optimization program) and participation in Mariel's free economic zone (ZDEM). The last type are reforms

that are often viewed as market liberalizations but that I prefer to interpret as broad relational contracts that expand civil liberties of Cuban citizens. For instance, the ability to buy, sell and own assets, to migrate, and to have land in usufruct. Moreover, I also include among this type less visible but also fundamental reforms, e.g., allowing agricultural producers to sell to foreign hotels and restaurants.

The next section discusses elementary political economy aspects that provide insight into the interpretation and evaluation of the two structural macro reforms. Subsequently, an interpretation of the updating of the economic 'model' and associated reforms is provided by viewing them as a realignment of what the industrial organization and law and economics literature would call relational contracts, which are differentiated into narrow and broad. Finally, an interpretation and evaluation of structural reforms that expand property rights and, thus, one particular type of civil liberty is put forth. This civil liberty is the one usually associated with economic growth (Benyishay and Betancourt 2010; Alfonso-Gil, Lacalle-Calderón and Sánchez-Mangas 2014; Czeglédi 2014). A brief conclusion provides perspective on our analysis.

I. Macro Structural Reforms: A Political Economy View of Exchange Rate Unification & Tax Reform.

Exchange rate unification is one of the essential reforms needed by Cuba. This need has been known and agreed upon for a long time by all relevant agents. For instance, from the perspective of the Cuban government, a former Minister of Planning and the Economy calls it a critical challenge in evaluating its 50 years of revolution at the end of his 20 year- term as a minister in 2009 (Rodriguez 2013). Cuban economists have known about this issue for a long time, e.g., an impressive thorough analysis of the issue from a technical perspective has been available for at least ten years (Pavel Vidal 2008).

A recent panel of the Association for the Study of the Cuban Economy (ASCE) at its annual meeting was titled “Monetary Duality and Currency Unification”. Three papers were presented emphasizing technical issues by Cuban exile economists with extensive experience in international finance in both the private and public sector (Linde 2018, Luis Luis 2018, Romeu 2018). Their analyses view monetary duality and exchange rate unification as related but conceptually distinct issues. A recent posting by a Cuban economist in his blog about Cuba concludes by noting that whether monetary unification is accompanied by a maxi devaluation or a series of mini-devaluations is fundamentally a political decision (Monreal 2018). There is no disagreement on the need for exchange rate unification and an abundance of professional advice on the issue, which is not limited to the above references as can be seen from their own list of references.

Why hasn't it happened becomes an increasingly interesting and relevant question? One widely held popular view is that it is the convertible peso (CUC), and not the Cuban peso (CUP) widely used by the population, which needs to be eliminated (e.g., Echevarría 2014). The economic logic for eliminating the CUC rather than the CUP is simple. Cuba's economic activities fail to generate enough dollars (or foreign exchange more generally) for a unified currency at the CUC's rate of about 1:1 but might be able to do so at much lower rates such as the CUP's rate of 1:24 or 25. As noted earlier who benefitted from introduction of the CUC and who loses from its elimination is not that hard to identify (Betancourt 2015).

When dollarization took place in 1993 there was a redistribution of wealth in Cuba towards people who had direct access to dollars for a variety of reasons, including friends and relatives abroad or strategic placements in the Cuban government hierarchy that generated this direct access. This redistribution process eliminated many loyal supporters of the regime from

being economic elites even though they remained politically elite. The CUC was a mechanism under the sole control of the Cuban government. It initially provided access to dollars on a 1 to 1 basis for these suddenly marginalized political elites.¹

Given the passage of time since its introduction, however, the set of beneficiaries of the CUC's and the set of those who must live by the CUP have experienced a variety of dramatic changes as a result of policy changes and exogenous shocks. Anyone with direct access to dollars or other foreign currencies manages a lot better having to live by the CUP than those without direct access, especially relative to those who don't have access to CUC's. At any point in time we have four sets of citizens: Cuppies, only access to CUP's; Cucupies, only access to CUP's and CUC's; Cupifes, only access to CUP's and foreign exchange; and Chévres, access to all three means of exchange. Policy changes and exogenous shocks to the system redistribute citizens among the four groups and change the welfare of being in any one group. The politically marginalized elites are primarily among the Cucupies but some may exist among the Chévres if their access to foreign exchange is very limited.

Policy changes that allow increased migration and increased remittances or the opening up of relations with the US and its reversal are dramatic changes that generate positive and negative shocks for how the citizenry redistributes itself among the four groups and their levels of welfare. For instance, one Trump reversal of Obama's opening led to a lowering of the welfare of the Chévres who were also former Communist Party members or retired military by limiting their ability to receive foreign exchange. If the limitations were complete in eliminating direct access to foreign exchange for the Chévres, they would unhappily become Cucupies. The

¹ A brief account of the evolution of the CUC in the context of a history of recent monetary policy in Cuba is provided by Hernández-Catá (2014).

latter would have a strong incentive to resist currency unification and there would be more of them in the set. A different impact on welfare of these policy changes is provided by the Cuppies who would always have an economic incentive to favor currency unification as well as to migrate. Thus, Obama's opening in 2014 and the consequent increase in migration via the web foot/dry foot policy (Betancourt 2018) lowers their numbers and, thus, the weight of one set of citizens supporting unification. Elimination of the latter policy by Obama in January 2017 has the opposite effect.

A sad fact of economic life is that eliminating monetary duality, whether with a sudden devaluation or with a gradual one, is going to generate winners and losers. If experience is any guide about policy changes, the former will never compensate the latter. Thus far, those with the most to lose, CUC holders without access to foreign exchange (i.e., Cucupies), have been successful, through luck or effort, in preventing implementation of the reform at the expense of those with the most to win, CUP holders without access to foreign exchange (i.e., Cuppies). The positions of the other two groups are harder to characterize in general.

Political economy considerations are also insightful on tax reform issues. More precisely on why certain aspects of tax reform will not happen. Namely, the Cuban state is desperate for foreign currencies and, thus, is unlikely to relinquish voluntarily (in the absence of extreme shocks) basic distortionary and inequitable taxing mechanisms by which it has been acquiring them. One specific valuable source to them is the system for taxing earnings of Cuban workers' in foreign companies investing in Cuba or working abroad. The lack of plans to change this system as part of the tax reform provides a compelling illustration. The system can be described succinctly as a mechanism to collect income taxes from workers' foreign earnings at confiscatory rates.

One anchor of the system for foreign enterprises investing in Cuba is requiring them to hire Cuban workers through the *Empleadora Nacional*. The latter is paid by the investor in foreign currency and the Cuban worker is paid in CUP's at, for example, 1\$:1CUP rate rather than at the \$1:25 CUP rate enjoyed by the government company. This amounts to a tax rate of over 95%. There are many variations that can improve on this rate for the Cuban worker and still keep it at a confiscatory level. Ironically, even at these confiscatory rates workers in this system are part of an economic elite as a result of their potential access to dollars or CUC's formally or informally. Indeed, their selection by the *Empleadora Nacional* to hold jobs with access to foreign exchange is usually conditioned on indicators that suggest their being part of the regime's loyal elites, e.g., membership in the Communist party.

This confiscatory income tax system is also applied to the dozens of thousands of Cuban government workers sent abroad under government to government agreements, including those serving in Venezuela. The latter have been subjected to income tax rates as confiscatory as the one above. Ironically, at the insistence of the Brazilian government a new agreement with Brazil lowered the rate the Cuban government receives in dollars directly for its doctors to 70%, while leaving 30% to be paid in dollars directly to the Cuban doctors in Brazil. While this was an improvement over the Venezuelan arrangement, especially since the wages for the doctors in absolute terms are fixed by the Brazilian government for all foreign doctors not just for Cubans, it is still a confiscatory rate. Indeed, an opposition candidate in the 2014 election in Brazil challenged this aspect of the agreement while supporting the program of bringing foreign doctors to the country.

Werlau (2014) argued that Cuba was repaying Brazil's investments in Mariel's ZDE by supplying Cuban doctors. She estimated that the supply of doctors to Brazil through the *Maís*

Medicos program would generate \$400 million to the Cuban government on an annual basis. This amounts to 20% of the estimated \$2 billion value of remittances by ECLAC in 2010 (Mesa-Lago and Pérez López, 2013: p.80). Since these investments failed to materialize, which is discussed in the next section, the example simply serves to provide an illustration of what I call a broad relational contract. Similarly, the 240% mark-up in the dollar stores operated by the government acts as a highly distortionary indirect tax or sales tax that captures foreign earnings from the citizenry, which arises out of another broad relational contract discussed in the next section.² It also serves as an illustration. Incidentally, on the expenditure side the government operated with relative efficiency from 1994 until 2012 when government expenditures moved toward an expansionary policy (Hernández Catá 2018).

II. Updating of the Economic ‘Model’: A Re-Alignment of Relational Contracts

Cuba’s evolving economic ‘model’ is conceptualized by the Seventh Party Congress in the following terms “We recognize the objective existence of market relations,” but “socialist planning is the principal way for the direction of the economy,” and “socialist[state] ownership of the means of production is the foremost form of the national economy.” (Mesa Lago 2018: fn. 4, p.143). What does that mean in practice? The Cuban state will allow several forms of non-state sector organizations (NSS) to operate in the economy but they do so under the guidance of socialist planning which reserves for state ownership the foremost form of organization. More generally, it is difficult if not impossible to describe Cuba’s economic ‘model’ in coherent terms from either a socialist or a capitalist perspective.

² While normally sales taxes are viewed as regressive, it is not clear that this would be the case in Cuba since it is the economic elites that have access to foreign currencies.

Rather than attempting the impossible, I propose to characterize the old system before the reforms as a set of relational contracts and the proposed new system through reforms as entailing a new set of relational contracts, which can include, exclude or modify previous ones. This view is useful for understanding the reforms identified as attempts to update the model. These reforms are far less perplexing from this perspective than from the alternative perspectives associated with any coherent ideological model. In doing so, it is useful to be precise about two different meanings of relational contracts: narrow and broad.

Narrow relational contracts as a concept stem from the industrial organization literature. A seminal paper (Baker, Gibbons and Murphy 2002) describes them as informal agreements and unwritten codes of conduct that powerfully affect behavior both within and between firms. The authors rely on game theory to differentiate the ones that underlie vertical integration (within firms) from the ones that underlie horizontal relations or connections between firms in terms of supply chains, alliances or networks. These type of contracts emerge to help circumvent difficulties in formal contracting when enforcement through an impartial third party is not feasible or is too costly. This can happen for a broad variety of reasons, ranging from absence of the rule of law to high costs of enforcement and other forms of transaction costs. For instance, verifiability may be impossible due the existence of large amounts of private information or unforeseeable contingencies in determining responsibility for contract outcomes. These contracts have become a standard concept in the modern literature on the theory of the firm and have an own chapter, “Relational Incentive Contracts”, in *The Handbook of Organizational Economics* (Gibbons and Roberts 2013).

Broad relational contracts are harder to describe in neat and tidy terms but they apply similar considerations to interactions between institutions, other organizations and economic

agents. Indeed, the last two chapters of the above mentioned *Handbook* are included in a part titled “Beyond Firms.” One of the chapters is on “Corruption” and the other on “Delegation, Control and the Study of Public Bureaucracy.” More generally the Wikipedia definition of relational contracts, which stresses a legal perspective, views contracts as based on broad relationships by arguing “Thus, even a simple transaction can properly be understood as involving a wider social and economic context.” We will take this broad view to describe the relations between a government and its citizens, among governments and between governments and other organizations, e.g., firms, state-owned enterprises (SOE) either domestic or foreign. It also includes relations between combinations of these agents.

Our wide extension of the concept makes sense when there are many unstated expectations about the behavior of the parties, a presumption of a continuing relationship between the parties involved, and no formal enforcement mechanism that can be reasonably provided by an impartial third party. In broad terms these are the same conditions that underlie the rationale for narrow relational contracts. Nonetheless a principal difference, and a main weakness in this broad definition relative to the narrow one, is that the logic of a self-enforcement mechanism consistent with the equilibrium of a game defined in terms of pay-offs to economic or political agents subject to constraints of various types is much more difficult to apply in a broad setting. Notwithstanding, a similar objection can be made to recent applications of relational contracting in a different broad setting. For instance, they have been raised in an analysis of the impact of labor market institutions on unemployment insurance and trade (Barron 2014). Not surprisingly, it is now in a section of the author’s home page described as resting or retired papers!

Attractive features of both narrow and broad relational contracts are: they can improve or lower welfare of the participating parties; and their self-enforcement feature suggests that breakdowns in the conditions for their sustainability over time are not only possible but probable. With this perspective in mind we can now begin to consider some of the relational contracts between the state and its citizens associated with updating of the Cuban model. Two obvious and important ones that have been unilaterally renegotiated by the Cuban state are: the rationing system and the dismissal of state workers.

Journalists often report on how the state fails to provide the monthly amounts indicated in the ration book. For instance, a look at this issue early in the reform process (Rios 2014) concluded that the ration provides only one to two weeks of the allotted monthly amount. A more recent one (Archuleta 2017) quotes a merchant in a well to do neighborhood food market in Havana with respect to the monthly ration as follows: “It gives us only about 10 days’ worth of food for the whole month.” This system is part of a relational contract between Cuban citizens and the Cuban state that has survived since 1962, at least in name. In practice, it has been in the process of unilateral renegotiation or realignment for a number of years and the process has accelerated since the start of the reforms. In simple terms the Cuban state can’t meet this obligation and is, therefore, publicly renouncing the obligation to its citizens in this relational contract through policy changes that, for example, allow them to purchase food in CUP’s at free market prices in some stores or with CUC’s or foreign exchange at other stores.

Similarly, the Cuban state can’t afford for fiscal reasons to employ everyone regardless of their lack of productivity. Hence, the dismissal of state workers is a unilateral renegotiation of a relational contract between the Cuban state and its citizens, publicly announced as a reform, which renounces a standard obligation to its citizens – full employment-- embedded in any

typical communist state. Because citizens are supposed to have access to means for attaining a minimum standard of living in any state and specially in a socialist one, these two reforms require new or modifications of existing relational contracts to fulfill needs previously provided by adequate rations and assured state employment.

Part of the updating of the model is through changes in other relational contracts that make jobs, which satisfy these needs, more available to the population. A review of four books on alternative sources of non- state sector employment possibilities introduced by the reforms notes that, of the 1.8 million state workers to be dismissed announced by 2011, the four most dynamic non-state subsectors contributed the following number of jobs by the end of 2015: private self-employment, 507, 342; usufruct farmers, 312,342; and nonagricultural and service cooperatives, 7,700. That is, they provided 17 percent of the labor force jobs (Mesa-Lago 2017). Incidentally, these four alternatives constitute less than 50% of the 2011 announced target. Other non-state sector forms are: small farmers, who own their land and have existed since 1959; and two types of agricultural cooperatives that existed before the reform process. The small farmers are estimated to be 99,500 in 2014 and the cooperatives would account for almost all of the remainder of the non-state sector labor force (Mesa-Lago 2018: Table 2, p.6). Nonetheless, these estimates entail sufficient issues that two alternative numbers are provided in Table 2 for the total percentage of labor force in the non-state sector: 22.8 % and 35.8%!

Since the state wants to preserve the benefits of other relational contracts, new limits on some self-employment occupations were imposed as the need arose due to conflicting objectives. For instance, seamstresses were forbidden to resell clothing items as part of their activities in October of 2013. Their ability to do that on a substantial scale was made feasible by the new migration law, which allows them or others to visit the US frequently since January 2013. By

taking advantage of these arbitrage opportunities, they significantly lowered the profits of the 240% mark-ups of the government-operated dollar stores mentioned in the previous section. Thus, this aspect of the broad relational contract between the state and this segment of its self-employed citizens was modified, ex-post, to maintain or restore the ex-ante benefits of those setting the contract terms through the government-operated dollar stores (Chévres in the terminology of the previous section). The contract setters were associated with current or former segments of the armed forces according to popular rumors. The extent to which the decree is abided by or enforced is difficult to ascertain.

More generally, the private self-employment sector has been around in very visible form and subjected to varying restrictions since the 1990's. Nonetheless, it experienced significant growth as a result of the 2011 structural reforms growing from about 147,000 in 2010 to a revised figure of 505,342 in 2015 (Mesa Lago 2018: pp12-13). A detailed analysis of its current role in the context of these reforms and recent changes announced by the government from the perspective of those operating in the sector is available (Mesa-Lago 2018: Ch.2). A Cuban economist is quoted by Mesa-Lago on these recent changes (p.22) "the worst outcome for the Cuban economy... is the decision to curb the experiment of agricultural distribution...". This decision eliminated incipient wholesale markets and returned the agricultural sector to the old *acopio* system. The interviews with participants provide a variety of insights into the sector and what the participants view as essential needs for their operations limited by recent changes. An evaluation of state policy towards the non-state sector implemented most recently, from August 2017 up to the end of July 2018, uses terms such as 'the revenge of a jealous bureaucrat' and describes in detail the unsuccessful efforts of the self-employed to be heard by the government in designing these changes to their relational contracts (Henken 2018).

Other broad relational contracts have been modified to increase employment through the reforms. For instance, foreign direct investment contracts, mentioned earlier, were expected to increase in numbers as a result of approval of a new foreign investment law announced in March 2014. Due to the new law limitations (Luis 2014), however, additional jobs were expected to be provided through Mariel's special economic development zone (ZEDM). The conditions associated with Brazilian investments in Mariel's ZED, discussed in the last section, illustrate a broad relational contract involving a variety of economic agents, ranging from Cuban citizens to the Cuban and Brazilian governments and a well-connected Brazilian conglomerate, Odebrecht. A recent evaluation of ZEDM from 2013 to 2018 describes it as a collapse, e.g., of \$12.5 billion expected project investments only \$1.191 billion have materialized (Morales 2018). Of course Odebrecht's investments have been limited by the company's association with the Lava Jato scandal, which has led to indictment and convictions of two former Brazilian Presidents (Lula and Rousseff) and the resignation of a Peruvian one (Kuczynski).

Allowing cooperatives outside agriculture is a reform that provides a new broad relational contract between Cuban citizens. It can create jobs needed as a result of the renegotiated relational contracts resulting from the dismissal of workers and inability of meeting citizens' needs through the rationing system. An irony of this reform is that one of its ardent proponents and supporters (Piñeiro Harneker 2011: Prólogo, pp. 8-9) stresses in her arguments their democratic features to promote solidarity and defend socialism. Upon implementation by the Cuban government, however, some of these features were eliminated leading Piñeiro Harneker to become a critic of the implementation (Bye 2014). The lack of these features may also explain the small number of jobs created, thus far, reported above. A chapter in Mesa-

Lago's recent book is devoted to a detailed description of their characteristics, environment and evolution in this early and obviously experimental phase (Mesa Lago 2018: Ch. 4).

More generally, the reforms discussed in this section, and others not classified as structural such as those associated with *perfeccionamiento empresarial* (*enterprise optimization program*), which are directed to increase productivity in SOE's, can be viewed as updating the model through changes in the nexus of both narrow and broad relational contracts underlying the old system. This re-alignment is consistent with the survival needs of the regime under new circumstances, including a substantial lowering of subsidies from foreign sources created by the Venezuelan collapse. At the same time this re-alignment of relational contracts maintains support from the population and acceptance of the regime and of the socialist system given that the old nexus of relational contracts can no longer do so. It provides mechanisms for subsets of cuppies and cucupies to become cupifes and chévres and represents a sensible accommodation to the logic of survival under a new set of circumstances.

Last but not least, it is worth noting that relational contracts of either the narrow or the broad type are not unique to Cuba but exist everywhere. Indeed, one could argue that these contracts are increasing in importance as a result of globalization, since the latter reduces the effectiveness of impartial third party enforcement mechanisms in any one country. Meanwhile supranational bodies have not become equally effective as the best within country impartial third party enforcers among developed countries. Ironically, the current populist wave across the world seems to be undermining the operation of impartial third party enforcement mechanisms within countries everywhere, including advanced countries. One interesting source of differences between countries is in the effectiveness of impartial third party enforcement mechanisms associated with the rule of law.

Where the rule of law is less effective more relational contracts are necessary to fill the gap. In this setting the set of corruption opportunities expand since there are more opportunities and incentives to break formal rules without consequences. One definition of corruption in the organizational setting suggests a positive association between the extent of relational contracts and corruption. Namely, corruption can be viewed as “... the breaking of a rule by a bureaucrat **(agent in an organization)** for private **(personal)** gain.” The bold face indicates our adaptation or simple generalization of the definition adopted in the essay for the *Handbook of Organizational Economics*. (Banerjee, Hanna and Mullainathan 2013). Under this definition the extent of the need for relational contracts provides a guide to the extent of incentives and opportunities for corruption in a society. Whether or not these opportunities and incentives are taken advantage of by economic agents in a society depends on a variety of other factors, including culture, that are beyond the scope of this essay.

III. Market Liberalizations or Broad Relational Contracts?

The reforms under the rubric of market liberalizations could also be viewed as part of an updating of the model and considered as an explicit modification or replacement of existing relational contracts. Indeed, this approach to analyzing changes in an economic system can be applied, for example, to understand other changes in an economic system such as those due to macroeconomic policy dynamics.³ For, the changes induced by the policy lead to: 1) a new but continuing relationship between the policy maker and economic agents; 2) outcomes that depend on unstated expectations and assumptions about the behavior of both parties; and 3) lack any

³ I owe this point to a question raised by Luis R. Luis on the earlier paper.

possibility of formal enforcement by an impartial third party. Whether or not a new equilibrium is generated as a result of the policy changes is uncertain.

Market liberalizations involve property rights and civil liberties in a fundamental way and, thus, they can also be viewed as a break from the ‘model’ as typically conceived. Many observers would view the typical Marxist- Leninist conception of socialism to exclude any significant role for private property rights. This was especially true for Cuba, except for brief interruptions (e.g., 1980-85), during the almost 50 years Fidel was in command. I adopt the perspective of broad relational contracts rather than market liberalizations here because the limits placed on these structural reforms since their initial announcements, especially after the Seventh Party Congress, prevent them from operating in the same way that market liberalizations involving civil liberties have operated in other environments where they have led to substantial economic growth, e.g., as in China or Vietnam.

While other differences between Cuba and these two countries would have led them to operate in different ways, the current limits on reforms ensure that they don’t have a chance of moving the economic system to a substantially higher growth equilibrium. For instance, the degree of transformation from agriculture to industry possible in Cuba relative to China and Vietnam, the relative small size of the country, and the international environment in which the liberalizations would have taken place lead to substantial differences in how market liberalizations through expansion of civil liberties could affect growth (see Betancourt 2015 for detailed arguments). Hence, under current circumstances, it makes more sense to view these reforms as introducing broad relational contracts rather than relaxing relational constraints (Shannon 1948) shifting a complex system onto a new equilibrium (Juarrero 1999).

Let's identify in detail the fundamental reforms under consideration as associated with changes in property rights through expansion of civil liberties as the introduction of broad relational contracts. First, they include the ability to sell, purchase and own assets such as houses and cars. While the housing market has thrived as a result of the reform, the automobile one has floundered since the initial purchase prices on newly available cars were set at very high levels. The ability to purchase and own durables such as air conditioners, computers and cell phones has been liberalized to some extent, but the right to sell or even alienate these items remains somewhat circumscribed. I will focus on the housing market due to its relative success and the importance of its potential economic impact on individual and social welfare. Second, the right to migrate internationally has been substantially extended in meaningful ways even though some restrictions remain. I will emphasize this aspect rather than the right to migrate internally due to its being a civil liberty with a profound impact on individual Cubans' welfare and the relative availability of information on the topic. Finally, the usufruct of land has also been liberalized together with the ability to sell items to non-governmental entities. I will focus on usufruct since it is an interesting often ignored aspect of property rights and there is accessible although limited information on the topic.

It is fair to say that in general these new broad relational contracts between the Cuban government and its citizens have improved the well-being of a substantial number of Cubans relative to the old 'model' restrictions. While the distribution of these improvements has been uneven, it is hard to believe that these new spaces for individual economic activity, whatever one calls them, would have decreased anyone's welfare in absolute terms unless envy is given a substantial role in the welfare function. Perhaps devout believers on the moral superiority of a command economy or equally devout haters of all things associated with the regime would be

willing to make that argument, but it makes little economic sense in the absence of envy or fairness considerations.

Interestingly enough, these three new broad relational contracts can be viewed at the macro level as improvements taking place in the subcategory of civil liberties that Freedom House labels Personal Autonomy and Individual Rights (G) (e.g., Piano and Puddington 2006). It includes all decisions most directly related to economic activity (and has a maximum score of 16). From a score of 4 in 2012, Cuba has improved to 6 by 2018. Similarly, Freedom of Expression (D, with a maximum of 16) in Cuba has gone from a score of 3 in 2012 to a score of 5 in 2018. There has been a decrease or constancy in liberalization for the other two categories of civil liberties during this period, i.e., Freedom of Assembly (E, with a maximum of 12) went from 1 to 0; and Rule of Law (F, with a maximum of 16) remained constant at 2. Political rights have not been addressed in any meaningful fashion by the reforms. Cuba's scores in the three political rights subcategories (A-C) measured by Freedom House did not change between 2006 and 2012 or between 2012 and 2018, remaining at 0, 0 and 1, respectively. The maximum scores in these subcategories were 12, 16 and 12, respectively.

Just for the sake of comparison, the scores for the political rights aggregate in China, Cuba and Vietnam were 3, 1 and 2 in 2012 and 2, 1 and 3 in 2018, respectively (the maximum score was 40). With respect to the civil liberties aggregate the scores for the 3 countries were 14, 10, and 17 in 2012 and 14, 13, and 17 in 2018, respectively (the maximum score was 60). In terms of the economic rights category (G) containing these three broad relational contracts' activities, the scores were 6, 4 and 8 in 2012 and 6, 6 and 8 in 2018, respectively. Thus, Cuba's reforms with respect to broad relational contracts affecting property rights directly during this period were associated with improved outcomes at the end of the period comparable to those

enjoyed by China but well below Vietnam's at the beginning of the period. For comparisons with other countries, the original source has scores available for over 200 countries or territories at <https://freedomhouse.org/content/freedom-world-data-and-resources>.

Let's consider now the economic impacts of allowing Cubans in 2011 to sell and buy houses for the first time since 1960.⁴ They represent a substantial expansion of civil liberties in the form of Personal Autonomy and Individual Rights by allowing Cuban citizens not only to consume the services of their dwellings and/or use parts of them to generate income, which had been allowed before, but also to sell or alienate these dwellings. These economic effects are potentially quite important and affect every person who can claim his/her home as their dwelling (85 % of the population in 1960 according to Mesa-Lago 2018) by creating an asset that can have a value determined by the market. Implementation through the initial decrees in principle allowed this asset to be used for a variety of purposes directly or as collateral. From the point of view of the property rights literature these effects can be viewed as a 'titling' effect (see the pro's in de Soto 2000; and the qualifications in Woodruff 2001), a house 'liquidity' effect supporting internal or external migration (see Chernina, Dower and Markevich 2014), an 'emancipation' from political control effect through its ability to generate income (see Dower and Pfitze 2014), or simply as an improvement in consumption possibilities effect.

Not surprisingly, implementation problems abound. For instance, there is an incentive on the part of participants to undervalue the asset as its legalization by a notary public is associated with a 4% sales tax that needs to be paid to the state when the sale is executed. Interviews with

⁴ A detailed description of the antecedents and the evolution of legal and informal possibilities and obstacles for the buying and selling of dwellings in Cuba since 2011 is available (Mesa –Lago 2018: Ch. 5). This discussion also includes legal and practical issues with respect to construction improvements required to put properties on the market.

ten buyers and ten sellers conducted in Havana municipalities during September of 2015 are reported by Mesa-Lago (Ch.5). All the interviewees did or do own their dwellings and had bought or sold them since 2011. Among the responses most salient features were: 60% of interviewees built their own dwelling and 65% took at least 7 months to buy or sell a house; the seller had to register the house and notarized the sale; prices of houses in CUC's ranged from 5,000-10,000 (30%) through 11,000-20,000 (60%) to 21,000 – 30,000(10%); and, 75% of interviewees view the 4% sales tax as adequate, mainly because it was based on the house's assessed value not on its real value.

With respect to the broad effects of property rights identified in the development literature, the interviewees indicated use of the sale value of the house for a variety of purposes (Mesa-Lago 2018: Figure 23) useful to illustrate these effects. For instance, 25% of the use was for the improvement and purchase of another dwelling, or the 'titling' effect; 12.5 % was for traveling abroad, or a potential house 'liquidity' effect; 31.3% can be viewed as an 'emancipation' from political control effect in the present through investing in a business (12.5%) or potentially in the future through savings (18.8%); finally, 31.2% use the asset to finance current consumption possibilities. Interestingly, no interviewees had applied for micro credit (although 8% wanted better access to bank credit to finance their dwellings). Hence, the use of the asset as collateral, despite its new legal status, doesn't seem to be widely exercised at least formally. In terms of its impact on Cuba's citizens, this new asset, which is usually transacted in CUC's, provides a mechanism for Cuppies to become Cucupies, for Cucupies to increase their holdings of CUC's, for Cupifes to become Chévres and for Chévres to increase their holdings of CUC's.

Five brokers were also interviewed to gain a broader perspective on the process. While their replies were not tabulated due to their small sample size, their more insightful comments on the nature of the market are discussed in the chapter. For instance, the house price range is wider than for the sampled buyers and sellers; 3 of the 5 reported 10-20% of their sales outside Havana province (the other 2 concentrate on Havana province, exclusively). Their view of the 4% sales tax was reported as “exorbitant”, in contrast to buyers and sellers. Nonetheless, they all reported that their earnings exceeded their costs. They identified the main problem in the market as the high price of housing and the consequent inability of current salaries to allow buyers to pay those prices. Only 10 % of the buyers and sellers in Mesa-Lago’s sample reported using a broker.

Consider next the right to migrate (temporarily or permanently depending on your definition of the terms, see Dustmann and Görlach 2016 for a discussion) which also falls under the category of personal autonomy and individual rights and allows citizens expanded choices with respect to where to live and where to work. This expanded right was one of the reforms officially acquired by Cuban citizens in January of 2013. In the Cuban context their official view of migration affected by the law is captured in their statistics. The latter consider a person an emigrant if they stay out of the country continuously longer than a year.

An important feature changed by the law in 2013 was the costs of staying out longer than a year in terms of loss of citizenship rights, by allowing persons to stay for two years, renewable twice. This meant you could explore becoming a permanent migrant at very low cost in terms of opportunity costs in the country of origin relative to the prior situation. A second important feature that the law changed affected both types of migration but especially so temporary migration of less than a year. You no longer had to get an exit permit, which was bureaucratically painful and expensive. All you needed was to pay \$100 for your Cuban passport

(and an entry visa for the countries requiring them, which was the same as before) with additional restrictions for essential personal (e.g., security services and some others). These restrictions have been liberally interpreted contrary to some expectations.

Undoubtedly the empirical impact of both features of the migration law associated with person flows to the US and out of Cuba have been substantial (Betancourt 2018). For instance, the increase in Cuban permanent migrants and Cuban tourist visitors to the US between 2012 and 2016 was at least twofold (Tables 1.1 and 1.5); the increase in visa less aliens admitted to the US during this period was at least fourfold (Table 1.2). Fluctuations in person flows out of Cuba have been dramatic (Table 1.4). While association does not mean causation, the strength of these ones and the mechanisms identifying them are strongly suggestive of a causal ‘voting with your feet’ effect.

This reform considerably enhanced the ability of Cuban citizens, in general not just the political elites, to generate income from their human capital and accumulate assets both in Cuba and abroad. An anecdote illustrates the point with respect to tourism or temporary migration. Recently I met a young Cuban artist abroad who claimed he could not work in Cuba directly. But he was able to make enough money as an artist working outside of Cuba temporarily to live comfortably residing in Cuba most of the year and even to be able to open up spaces for other artists to work there. He was a Cuppie who became a Cupife as a result of the migration reform and eventually could become a Chèvre by purchasing a house in CUC’s with his foreign exchange earnings. By introducing a new relational contract between the government and its citizens through expanded migration possibilities, the state’s obligation to provide a standard of living was being satisfied without the rationing system or a government employment contract. Furthermore, in the case of this particular anecdote, it also generated foreign exchange that could

be captured in Cuba when the artist returned to live there a substantial part of the year. A win-win label without a doubt, at least in the short-run.

Last but not least we have the expansion of usufruct, which allows the cultivation of land owned by the government through ten year contracts extendable for another ten years provided the farmers fulfill all their obligations to the state. In 2012 a more flexible law to regulate usufruct was introduced. A discussion of its background, provisions, potential impacts and the views of 25 usufruct interviewees gathered between April and September 2018 are available (Mesa-Lago 2018: Ch.3). Part of the law's importance arises because usufruct is viewed as the key to agrarian reform and a move to the market during Raul's term. Improvements in the 2012 law included substantial increases in the maximum size of the parcel, ability to construct dwellings and plant orchards, subsequent tax advantages, access to credit and the hiring of contracted workers but restrictions remain and some advantages were subsequently eliminated, including an experimental wholesale market as indicated earlier.

It is difficult to provide empirical evidence on actual outcomes because separate statistics on usufruct farmers are usually not available from official sources. One interesting result derived from the 25 interviews, however, is that 88% of usufruct farmers are sufficiently satisfied with what they do and earn to answer in the 7-10 range on a 10 level scale to this question. Their average size of parcel (34 acres) is substantially below the new maximum (67 acres); 56% had to clear marabú (a difficult to clear weed) from the parcel; 0% had constructed a house or a barn, 32% raised cattle for milk and 68% planted different crops; only 20% had planted trees; 44% had employees and 92% had net profits; all but one had ties to credit and service cooperatives (CCS); only 32% received remittances; and over 50% purchased inputs from CCS.

For comparison purposes, note that the usufruct contracts in China and Vietnam are either indefinite or for 50 years and the farmers decide what to plant, whom to sell to and fix market prices. Not surprisingly, the most thorough analysis of Cuba's agricultural transformations, including the recent reforms governing usufruct farming, view as necessary three types of enhancements relevant to all farmers: 1) the realization of property relations in agriculture critical to all farmers (e.g., choice of what to produce), 2) complementarity of their interactions with the market system, and 3) a systemic focus on the overall production cycle that affects farmers (Nova and Gonzalez-Corzo 2015).

Agricultural markets have been described as spontaneous or irrepressible markets and contrasted to some types of modern markets, which are described as 'socially contrived' markets, Clague, Keefer, Knack and Olson (1999). Examples of socially contrived markets would be insurance markets and financial markets, including mortgage markets. Since the benefits of transactions in agricultural markets tend to be simultaneous in space and time, if governments provide a minimum of law and order, they can function at a relatively high level of transactions regardless of the prevalence of the rule of law. One implication is that from a property rights perspective eliminating many of the restrictions on usufruct (and on farmers in general) could generate a substantial expansion in agricultural output. Hence, both Cuban economists in the island and those outside the island seem to agree on what needs to be done and it is a political economy question why it is not done.

A Chinese government expert once told me that in urban areas the Chinese government is far more sensitive to the needs of the population than in rural areas for two obvious reasons: communications spread faster and civil unrest is more visible. From this cynical vantage point one would have limited expectations for change in usufruct restrictions in the absence of major

shocks, e.g., famines. In terms of the impact on the usufruct farmers, these reforms tend to leave them in the same categories with respect to their holdings of CUP's, CUC's and foreign exchange but allow them to increase their holdings of all three types of means of exchange in principle. Considering their annual tax payments in the lowest category (200 -1,000) relative to the self-employed (1440 -2400) are less than half of the self-employed at the upper bound of the category, however, one would expect most of them to be Cuppies. Hence, they would benefit considerably from an expansion of the possibilities to generate income under usufruct despite their reported satisfaction levels.

IV. Concluding Remarks

In sum, time has told on Cuba's structural or fundamental reforms. The earlier hopes of profound transformations have been squashed by the realities of seven years of hesitant and halting expansions accompanied by serious backtracking on fundamental reforms. This was the case under Obama's secret negotiations, started in 2013, after the December 2014 opening of substantial economic opportunities, and after Trump's closing of some but not necessarily many of these opportunities. Nevertheless, political leaders fear of change, both old and young, and their seeming desperation for control of irreducible uncertainty has stifled policy innovations even in the presence of well-known paths followed by other economies. One hopeful message from this analysis is the potential for success of the reforms of the non-state sector if they are ever undertaken enthusiastically and exploited to their fullest extent as economic mechanisms. Unfortunately, until the political will to change penetrates the principals, Cuba's political elites, and this message gets unequivocally transmitted to their agents, small minded bureaucrats, Cuban citizens hopes of economic development are wishful thinking. Enrichment possibilities

for a selected few at the expense of fellow citizens, however, will always be there. *El tiburón se baña, pero no salpica.*

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