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Cuba "Updates" Its Economic Model

Perspectives for Cooperation with the European Union

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Cuba "Updates" Its Economic Model
Perspectives for Cooperation with the European Union

The thaw in relations between Cuba and the United States has created a new political and economic basis for integrating the Cuban economy more closely into international trade and investment flows. The great interest in closer cooperation shared by Cuba itself, the governments of the industrialised nations and the business sector raises the question of opportunities for cooperation with the EU and Germany potentially arising through the transformation of the Cuban model. Are the reforms initiated in Cuba suited to transform the country's external position? And do they improve the situation for collaboration with the European private sector, and/or for development cooperation? Cuba's current trade situation and its embedding in the WTO and regional trade agreements also represent cornerstones for future developments. Another question of interest is the extent to which the German-Cuban declaration of 2015 and the 2016 EU-Cuba Cooperation Agreement offer a perspective for the EU to return to a united policy on Cuba, after a long period in which member states have pursued different positions.

Cuba has struck a new economic course since Raúl Castro succeeded his brother Fidel as head of state and party leader. Raúl believes that the causes of Cuba's economic difficulties are largely of its own making. The "guidelines" *(lineamientos)* for updating the country's economic model adopted in response in 2011 set the scene for sweeping changes. The central trade policy objectives are to diversify and expand exports, and to substitute imports. The thrust of the latter is principally to improve the country's self-sufficiency in energy and food. Cuba is also seeking greater independence from Venezuela, which has been a crucial supporter but is now mired in economic and political difficulties of its own.

While the reforms also introduced a legal possibility for self-employment (*cuentapropistas*), the narrow restraints under which it currently operates offer little prospect of meaningful opportunities for diversification or expansion of exports. In tourism, however, the reforms could have a wider impact. The growing number of cooperatives, especially in agriculture, has thus far yielded only small increases in productivity and is more likely – starting from a low baseline – to contribute to import substitution. Growth in exports can only be expected in the longer term, if at all.

However, all these possibilities depend strongly on whether the Cuban government realises accompanying reforms in the areas of infrastructure and production-related services. The most decisive aspect of all will be whether businesses and cooperatives are given greater entrepreneurial freedom on questions ranging from recruitment and pay to import needs. Tight government control creates negative framework conditions for internal actors and external investors alike, and undermines Havana's external economic objectives. The restrictions are driven by the government's wish to control all economic activities and the political-military elite's desire to secure its own power and wealth. Great tensions thus exist between political circumstances and external economic goals.

Today the European Union possesses significant weight in relation to improving Cuba's external economic perspectives, as the country's second-largest trade partner after Venezuela. But conversely, Cuba is economically insignificant for Europe, even if a number of multinationals from EU member states have larger investments there. In 2016 Cuba concluded a Dialogue and Cooperation Agreement with the EU, as the last Latin American country to do so. Although Cuba is geographically part of the Caribbean, and partially included in the region's political institutions, it stands outside the EU's formal ties with that region; this applies both to development funding and to the EU's Economic Partnership Agreement with the Caribbean which came into force in 2008. Unlike other developing countries, Cuba is excluded from the EU's non-reciprocal trade preferences, because a strongly overvalued exchange rate inflates its GDP figures.

While the future course of European-Cuban relations will thus be shaped by a complex web of economic and political conditions, a number of conclusions and recommendations for Germany and the EU can nonetheless be identified:

- The prominence accorded to Cuba in current debates exceeds its relevance for European economic/strategic interests. Germany and the EU should reassess whether special treatment for Cuba actually corresponds to their current interests, or whether it sends the wrong message to other Caribbean states.
- Cuba's economic and political anchoring in the region should be the starting point for its inclusion in the German and European instruments of development and trade policy towards CARICOM and the Dominican Republic (which together form CARIFORUM). This would also strengthen long-term regional cooperation and integration. This could at the same time test new forms of cooperation with Cuba and potentially facilitate dialogue on sensitive issues; in the external economic context for example on the role of small and medium-sized enterprises (SMEs).
- Circumstances are especially difficult for European SMEs. The German and European Cuba dialogue needs to be flanked by regular stakeholder discussions with the business sector, academia and civil society. This would help the German government and the European Commission to stay fully informed about the situation and activities of groups in Cuban society.
- The EU should use its cooperation agreement with Cuba – and Germany its bilateral agreement – to intensify dialogue on the issues of human rights, transparency and participation. These questions are closely bound up with the possibilities for achieving external economic goals, as they define the framework for economic activity. Cuba's need for external economic successes also offers openings for addressing politically sensitive topics.
- In the longer term, closer cooperation under the agreement with the EU will hopefully offer a chance to move towards more substantial European-Cuban arrangements, including in the area of economic relations and to further concretise the current agreement at some future point.

Starting Situation: Updating the Cuban Model as the Basis for Dynamic Growth?

Basic data

Cuba has a population of 11 million (2015) and annual per-capita income of $5,880,[1] officially making it a higher middle income country. In economic terms, it does not stand out especially in the region; per-capita income and population are nominally on a par with neighbouring Dominican Republic. But the Cuban exchange rate is strongly overvalued: alongside the convertible peso (CUC), which is tied to the US dollar at CUC24/$1, there is also a Cuban peso (CUP) with an exchange rate of 1:1. At an exchange rate of 12 pesos/$1, which observers regard as realistic,[2] Cuba's per-capita income would be much lower. De facto, Cuba should be regarded as one of the poorer developing countries.

To arrive at a proper assessment of Cuba's perspectives, however, one must examine the data at more granular level. Unlike other low-income developing countries, Cuba has very positive social indicators. The investments made after the revolution of 1959, above all in education, health and basic infrastructure, are still reflected in a high level of social development today. The UNDP's Human Development Index (HDI) ranks Cuba's sixty-seventh globally, with high life expectancy (79.5 years), long school education (11.5 years) and good access to water and sanitation (for 94 and 93 percent of the population respectively).[3] That said, a more realistic exchange rate would also lower the HDI by reducing per-capita income. Cuba scores less well on other indicators, such as communications (2014: 22 mobile phones and 30 internet users per 100 population). But the telecommunications situation is changing rapidly; the number of mobile phones passed three million in 2015.[4] This trend has been fostered by a sectoral trade opening, with US firms permitted to supply telecommunications equipment since January 2015. At the same time, state controls remain strong, especially in relation to internet usage.

Cuba's real economic growth in 2015 was 4.3 percent.[5] For 2016–2020 the Economist Intelligence Unit expects an annual average of 5.1 percent.[6] But a string of factors could force a downwards correction: low oil prices, crisis in Venezuela and uncertainty over the direction of US Cuba policy under Donald Trump. The normalisation of American-Cuban relations has been a factor contributing to recent positive expectations among political analysts and business actors.

After taking over as leader in 2006, Raúl Castro initiated a policy of reforms, spurred by a reassessment of the causes of Cuba's economic crisis. While Fidel Castro largely blamed the American embargo, Raúl identifies structural problems that needs to be tackled through internal change.[7] As such he is also addressing the challenge of fulfilling shifting internal popular expectations in relation to the legitimisation of the government. The likelihood of social protests is also expected to increase after Raúl Castro leaves the stage, as the last of the veterans of the revolution.[8] Comparisons with the pre-revolutionary era play little role for young Cubans today, who judge their government on the basis of its actual achievements. This places Havana under growing pressure to demonstrate economic successes.

The normalisation of American-Cuban relations, initiated in 2014 by President Barack Obama, enabled

1 Unless otherwise indicated, all data in this section from World Bank, *World Development Indicators, Cuba*, http://data.worldbank.org/country/cuba (accessed 23 June 2016).
2 Mauricio De Miranda-Parrondo, "Current Problems in the Cuban Economy and Necessary Reforms", in *No More Free Lunch: Reflections on the Cuban Economic Reform Process and Challenges for Transformation*, ed. Claes Brundenius and Ricardo Torres Pérez (Cham, Germany, et al., 2013), 41–62 (42).
3 United Nations Development Programme (UNDP), *Human Development Report 2015*, http://hdr.undp.org/en/composite/HDI (accessed 30 March 2016).
4 Germany Trade and Invest (GTAI), *Wirtschaftstrends Kuba Jahresmitte 2015*, 11.
5 UNCTADSTAT, http://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/192/index.html (accessed 31 January 2017).
6 Economist Intelligence Unit (EIU), *Cuba: Country Report*, March 2016, http://country.eiu.com/FileHandler.ashx?issue_id=1094025693&mode=pdf (accessed 10 January 2017).
7 Uwe Optenhögel, "'Wer zu spät kommt, den belohnt das Leben': Fünf Fragen zur EU-Kubapolitik und den Folgen der Reformen an Uwe Optenhögel in Brüssel", *Internationale Politik und Gesellschaft*, 24 March 2015, http://www.ipg-journal.de/interviews/artikel/wer-zu-spaet-kommt-den-belohnt-das-leben-852/ (accessed 4 January 2017).
8 EIU, *Cuba: Country Report*, 11 June 2015.

Cuba to reorientate its external economic and foreign policies. After decades of dependency on single partners – until the revolution the United States, later the USSR, then Venezuela – Cuba today possesses great interest in diversifying its economic and political external relations. Havana's active diplomacy, initiated through the Cuban-American thaw and reflected in numerous visits by high-ranking foreign guests, must be seen in that context. It remains unclear how Donald Trump's presidency will affect Cuba's nascent integration into international politics.

Updating the economic model 2011/2016

The Sixth Congress of the Communist Party of Cuba in April 2011 adopted a series of reform proposals, consolidated into a single comprehensive document;[9] the Seventh Congress in 2016 amended and expanded them.[10] As the introductory sentence of 2011 underlines, the guidelines are intended to "update Cuba's economic model with the objective of guaranteeing the continuation and irreversibility of socialism, as well as fostering the country's economic development and improving the standard of living of the population…".[11] These formulations reveal that the point of the exercise is by no means a fundamental overhaul of the economic system, but merely to implement reforms that appear unavoidable for achieving social and economic targets within the socialist economic model.

Under the guidelines, "socialist property of the entire people" *(propiedad socialista de todo el pueblo)* remains the foundation of the economic system. But certain elements of private entrepreneurship are now to be permitted, including foreign investment, cooperatives, small-scale agriculture, leasing and certain types of self-employment (*trabajadores por cuenta propia* or *cuentapropistas*).[12] It is hoped that these innovations will contribute to increasing efficiency and improving Cuba's balance of payments.

The scope of newly legalised self-employment is limited largely to unqualified functions in the service sector. One example is buying and selling second-hand books – "Activity No. 23" – which is widely practised at Havana's tourist hotspots; "Activity No. 49" regulates the work of covering buttons with fabric.[13] In order to promote self-employment, it has been made easier for Cubans to receive funds from abroad and invest them in private activities. Political analysts note that these changes are contributing to a strong increase in inequality in Cuban society, where access to convertible currency has become the key to social status. The losers are above all those who lack connections to the Cuban diaspora in the United States – pensioners, large parts of the rural population, single mothers and Afro-Cubans.[14]

Legislation passed at the end of 2012 permits cooperatives in the retail and service sectors, includeing the transformation of state-owned restaurants into cooperatives with up to twenty members (who must be former staff). The government has decided to lease the 8,948 state-owned restaurants to private operators.[15] The legislation also permits IT experts to join together to offer web design, internet and other services, as well as cooperatives of architects, accountants and consultants.[16] Transport cooperatives will, it is hoped, in particular expedite the distribution of agricultural products.[17] By May 2014, 498 cooperatives

9 VI Congreso del Partido Comunista de Cuba (PCC), *Lineamientos de La Política Económica y Social del Partido y La Revolución, Aprobado El 18 de Abril de 2011, "Año 53 de la Revolución"* [Sixth Congress of the Communist Party of Cuba, guidelines for economic and social policy for the party and the revolution, adopted 18 April 2011 in the 53rd year of the revolution]. Referred to as "guidelines" in the following.

10 VII Congreso del Partido Comunista de Cuba (PCC), *Actualización de Los Lineamientos de La Política Económica y Social Del Partido y La Revolución para El Periodo 2016–2021, Aprobados En El 7mo. Congreso Del Partido en Abril de 2016 y por La Asamblea Nacional del Poder Popular en Julio de 2016* [Seventh Congress of the Communist Party of Cuba, guidelines for economic and social policy for the party and the revolution for the period 2016–2021, adopted at the Seventh Party Congress in April 2016 and by the National Assembly of People's Power in July 2016, http://www.cubadebate.cu/wp-content/uploads/2016/09/aqu%C3%AD.pdf (accessed 1 February 2017).

11 Translated from the Spanish.

12 In the following "self-employment".

13 José Azel, "The Illusion of Cuban Reform: Castro Strikes Out", *World Affairs*, July/August 2013, http://www.worldaffairsjournal.org/article/illusion-cuban-reform-castro-strikes-out (accessed 10 January 2017).

14 Jenny Morín Nenoff, "Kubanische Perspektiven", *amerika21: Nachrichten und Analysen aus Lateinamerika*, 15 February 2015, https://amerika21.de/analyse/112143/kubanische-perspektiven (accessed 10 January 2017).

15 Mimi Whitefield, "Building the New Cuban Economy", *Miami Herald*, 13 December 2014, http://www.miamiherald.com/news/nation-world/world/americas/cuba/article4458040. html (accessed 10 January 2017).

16 Archibald R. M. Ritter and Ted A. Henken, *Entrepreneurial Cuba: The Changing Policy Landscape* (Boulder, Col., 2015), 190.

17 Julia E. Sweig and Michael J. Bustamante, "Cuba after Communism: The Economic Reforms That Are Transforming the Island", *Foreign Affairs* 92, no. 4 (2013): 101–14 (109).

had been approved, of which 329 were already operating, with another 300 applications pending.[18]

Cooperative modes of production already existed in Cuban agriculture. By the end of 2010 one million hectares of productive land had already been transferred to 108,000 individuals and 2,000 cooperatives.[19] In 2015 about 80 percent of agricultural production (but not consumption, it must be noted) originated from cooperatives.[20] The legalisation of private-sector activities has succeeded in increasing food production, with the largest gains recorded for products whose sale at farmers' markets has been legalised, and for those whose production is state-supported. But in international comparison Cuba's agricultural productivity remains very low.[21]

Controlled “freedom” – The dilemma of the update

The Cuban government prioritises “law, discipline and control” over the development of small businesses, as Raúl Castro underlined in a speech in December 2013.[22] The emergence of forms of private ownership represents a great challenge for the socialist model with its principle of equality. At the same time, the political ruling class fears the possibility of losing control over the economy. The Cuban economist Antonio Gómez from the University of Havana points out that the guidelines introduced ideas of efficiency and economic sustainability for the first time, whereas in earlier decades social development clearly enjoyed priority over economic aspects.[23] Social equality and the impact of innovations on different parts of society, however, remain a fundamental issue for the long-term success of the reforms. In this connection the economist Oscar Fernández Estrada argues that taxes alone are an inadequate instrument for preventing the accumulation of wealth in particular sectors. When power is transferred to companies, he argues, new mechanisms are needed to ensure that workers are able to influence company decisions.[24]

The self-employed in Cuba are currently taxed considerably more heavily than joint ventures, with effective tax rates of up to 100 percent.[25] On the other hand, small businesses with fewer than five employees are taxed considerably less heavily than larger firms. The scope for private business activities is defined by politically driven administrative rules, which are not necessarily logical. Arbitrary limits on the number of seats in private restaurants supplies one example: at first it was twelve, then twenty, and now fifty are permitted. Customer interests and economic success are irrelevant. Manuel Orozco from the US non-profit Cuba Study Group points out, for instance, that an individual may open a restaurant, but not a food-producing firm.[26] Moreover, a food business needs to employ staff with a wide range of qualifications in order to fulfil all the legal requirements: cooks, health experts, marketing specialists, food buyers and accountants. Another reason why self-employment initially remained limited was the lack of credit and the absence of wholesale suppliers. In the meantime, retail and wholesale markets have emerged since 2014,[27] also simplifying access to resources for the rapidly-growing private restaurant sector. More emphasis is given to the financial sector and lending, in turn, under the revised guidelines of 2016.[28]

18 Whitefield, “Building the New Cuban Economy” (see note 15), quoting Cuban Economy Minister Marino Murillo.
19 Angel Bu Wong and Pablo Fernández Dominguez, “Agriculture: Historical Transformations and Future Directions”, in *Cuban Economists on the Cuban Economy*, ed. Al Campbell (Gainesville: University Press of Florida, 2013), 270–91 (283).
20 International Fund for Agricultural Development (IFAD), “UN Agency Head Visits Cuba to Discuss Agriculture Reform with High-level Government Officials” (Rome, 7 May 2015), https://www.ifad.org/en/newsroom/press_release/tags/p31/y2015/7487627 (accessed 10 January 2017).
21 Anicia García Álvarez, “Cuba's Agricultural Sector and Its External Links”, in *Cuban Economic and Social Development: Policy Reforms and Challenges in the 21st Century*, ed. Jorge I. Domínguez, Omar Everleny Pérez Villanueva, Mayra Espina Prieto and Lorena Barbería (Cambridge, Mass., and London, 2012), 137–92 (147, 150).
22 Ritter and Henken, *Entrepreneurial Cuba* (see note 16).
23 Antonio F. Romero Gómez, *Transformaciones Económicas y Cambios Institucionales en Cuba* [Economic transformation and institutional change in Cuba], Foreign Policy at Brookings (Washington, D.C.: Brookings, August 2014), 22.
24 Oscar Fernández Estrada, “The Economic Transformation Process in Cuba after 2011”, in *No More Free Lunch*, ed. Brundenius and Pérez (see note 2), 23–39 (26).
25 Ritter and Henken, *Entrepreneurial Cuba* (see note 16).
26 Cited in Collin Laverty, *Cuba's New Resolve: Economic Reform and Its Implications for U.S. Policy* (Washington, D.C.: Center for Democracy in the Americas, 2011), 64.
27 Carmelo Mesa-Lago, “Can Cuba's Economic Reforms Succeed?” *Americas Quarterly* (Americas Society/Council of the Americas), 5 November 2014, http://www.americasquarterly.org/content/can-cubas-economic-reforms-succeed (accessed 8 June 2015).
28 VII Congreso del PCC, *Conceptualización del Modelo Económico y Social Cubano de Desarrollo Socialista* [Seventh Congress of the CPC, conceptualisation of the Cuban economic and social model of socialist development], 2016, http://www.granma.

The individual measures have come into effect more slowly than the leadership itself had expected, because the government is concerned to keep the repercussions under control and limit negative social impacts. In fact, according to the government, only 21 percent of the reforms had been implemented by early 2016.[29] Originally self-employment was supposed to absorb surplus state employees, with 500,000 redundancies originally planned for the first half of 2011 under the update process. In view of the slow growth of self-employment, part of the redundancies were postponed to the end of 2015.[30] De facto 365,000 state employees had been shed by the end of 2012, reducing the state's share of total employment from 82 percent to 75 percent.[31] By the end of 2014 the number of self-employed had risen to approximately 500,000.[32] But this still fell well short of the target of 1.8 million set for 2015.[33]

In any case, self-employment is not necessarily suited for absorbing surplus workers. At the end of 2011, contrary to expectations, only 18 percent of the new self-employed were redundant state employees.[34] This is in fact unsurprising, given that the qualifications of those shed by state-run enterprises do not necessarily match the requirements of the private sector. The result is the emergence of growing hidden (unregistered) unemployment. The early reform process also drew criticism for failing to strike an appropriate balance between economic adjustment and social support.[35]

As well as creating new jobs, self-employment under the "cuentapropistas" arrangements has had other positive effects on the Cuban economy and foreign investment. It serves, namely, to a certain extent, to legalise the existing shadow economy, with the new self-employed coming largely from the informal sector. Archibald Ritter and Ted Henken cite examples from the catering sector where people had in fact been self-employed for years. At the beginning they were legal, but went underground when the rules were tightened; now these individuals see an opportunity to legalise their business again.[36] The informal sector plays a major role in Cuba, and significantly interferes with the activities of foreign investors.

The shadow economy is in fact crucial to the survival of the Cuban economy as a whole. On the one hand it ensures that certain important services are provided at all; on the other it indirectly supports the state system. While not yielding tax revenues directly, hard currency earned in the shadow economy and spent at the official exchange rate functions as indirect taxation. At the same time, significant sections of the population have no alternative to seeking income outside of formal sector, because their earnings from regular employment are insufficient to cover their living costs.[37] So although self-employment constrains the state's ability to direct the economy, the partial formalisation of the existing shadow economy actually expands its control over economic activity and increases tax revenues. The proliferation of cooperative models could also contribute to a gradual undermining of the shadow economy and formalisation of an important section of the economy. A broader cooperative sector in the non-agricultural sphere could, namely, lead to a change in workers' attitudes. The widespread workplace problem of "petty theft" of socialist collective property might plausibly find less acceptance in cooperatives, where the workers own the business themselves.[38] Workplace thefts are, however, also an important economic input for the informal sector.

There is good reason to expect a string of positive effects from the currently permitted forms of self-employment, but also a risk of productive energy being directed into low-productivity niches rather than sectors with high added value. This is because self-employment has been legalised largely for unqualified jobs in limited areas, while the state fundamentally intends to retain tight control of economic

cu/file/pdf/gaceta/Copia%20para%20el%20Sitio%20Web.pdf (accessed 1 February 2017).

29 VII Congreso del PCC, *Actualización de Los Lineamientos* (see note 10), 4.

30 Ritter and Henken, *Entrepreneurial Cuba* (see note 16), 280.

31 Mesa-Lago, "Can Cuba's Economic Reforms Succeed?" (see note 27).

32 "Cuba's Economy at a Crossroads", *New York Times*, 14 December 2014.

33 Mesa-Lago, "Can Cuba's Economic Reforms Succeed?" (see note 27).

34 De Miranda-Parrondo, "Current Problems in the Cuban Economy and Necessary Reforms" (see note 2), 53.

35 Alberto Gabriele and Pavel Vidal Alejandro, "Cuban Reforms at a Crossroads", in *The Economy of Cuba after the VI Party Congress*, ed. Alberto Gabriele (New York, 2012), 131–48 (141).

36 Ritter and Henken, *Entrepreneurial Cuba* (see note 16).

37 Omar Everleny Pérez Villanueva, "The Cuban Economy: An Evaluation and Proposals for Necessary Policy Changes", in *Cuban Economic and Social Development*, ed. Domínguez et al. (see note 21), 21–38 (36).

38 Ritter and Henken, *Entrepreneurial Cuba* (see note 16), 191.

development.[39] The new economic incentives created by the guidelines have led to a phenomenon of highly qualified workers taking menial jobs – especially in the tourism sector – in order to earn hard currency. While university graduates comprise only 7 percent of the self-employed, they are also doing low-qualified subsistence-orientated jobs. This is one of the reasons why Cuba’s high level of education – which is better than in most developing countries – is not properly reflected in its economic performance.[40]

The extent to which the implemented measures will actually contribute to economic development and foreign trade will naturally also depend on whether the changes are lasting. This is particularly pertinent given that possibilities for private business were opened and closed again several times under Fidel Castro. First, the “revolutionary offensive” of 1968 almost completely abolished private forms of economic activity. In 1978, forty-eight categories of self-employment were legalised, but severely curtailed again in 1986. The deteriorating economic situation in 1993 forced another legalisation of various private activities, but this only lasted until 1995/1996.[41] Despite this record, experts today believe that the reforms under Raúl Castro will endure,[42] above all on account of the economic necessity, especially the loss of economic aid from Venezuela. The credibility of Raúl Castro’s reforms is underlined by the self-critical analysis with which they were launched, which blamed Cuba’s desolate economic situation more on internal problems than on the US embargo and other external factors.[43]

Yet fear that economic reforms could create political difficulties is not the only reason behind heavy restrictions on private-sector activities. The military elite’s concern over potential economic losses also plays an important role. “The militarisation of economic life and the levers of power – where state-owned enterprises are run by members of the military – is one of the measures introduced by Raúl Castro to manage and politically anchor the economic opening.”[44] The military thus controls a large part of the economy,[45] and has a strong interest in preserving its access to power and wealth. Implementation of the reform process is further hindered by other state functionaries who profit from the existing system; they form a large group, because the state sector is large and lacking in transparency and clear rules.[46]

The government’s desire to retain control of the central means of production is reflected in tight constraints, which in turn currently block the growth of SMEs. It is also problematic for economic development that such constraints do *not* apply to mixed foreign/state joint ventures.[47] Yet new SMEs would represent an important counterweight to the large state-run enterprises and military-owned combines (where there is a risk of the latter turning into at least semi-private monopolies). Rapid growth of the newly legalised cooperatives could be an especially rewarding route. While they already exist in many countries, cooperatives could attain greater significance in Cuba as the foundation of a “mixed cooperative market economy”,[48] which would be certain of global attention as an alternative model beyond socialism and capitalism.

The changing internal conditions also create a basis for stimulating Cuba’s external economic relations, to the extent that the reforms contribute to improving efficiency and expanding production and supply (of services). However, the potential of self-employment presently lies above all in the field of tourism, and the tight restrictions make direct trade-related activities in self-employment almost unimaginable. Expansion of the cooperative sector, on the other hand, offers a route to ultimately also influence trade in goods. But creating further potential for expanding and transforming foreign trade will require great improvements in the framework conditions for commerce and investment.

39 Eric Hershberg, “Cuba: An Economy Careening Forward, Destination Unknown”, in *No More Free Lunch*, ed. Brundenius and Pérez (see note 2), v–ix (viii).
40 This criticism is voiced both internally and internationally. See UNDP, *Human Development Report* (see note 3), or Gómez, *Transformaciones Económicas* (see note 23), 21.
41 Ritter and Henken, *Entrepreneurial Cuba* (see note 16), 297ff.
42 See Bert Hoffmann, *Wie reformfähig ist Kubas Sozialismus?* (Berlin: Friedrich-Ebert-Stiftung, May 2011), 3; Laverty, *Cuba’s New Resolve* (see note 26), 60, or Ritter and Henken, *Entrepreneurial Cuba* (see note 16).
43 Gabriele and Alejandro, “Cuban Reforms” (see note 35), 136.
44 Translated from Günther Maihold, *Vom Sonderfall zur Normalisierung: Kuba und die Europäische Union suchen erneut den Dialog*, SWP-Aktuell 34/2014 (Berlin: Stiftung Wissenschaft und Politik, May 2014), 4.
45 Azel, “The Illusion of Cuban Reform” (see note 13), cites 60 percent.
46 Gabriele and Alejandro, “Cuban Reforms” (see note 35), 143.
47 Ritter and Henken, *Entrepreneurial Cuba* (see note 16), 302: “Of course, these same limitations do not exist for mixed or joint ventures between foreign owned and state enterprises – a disappointing feature of Cuba’s new foreign investment law published in 2014.” See also the discussion of investments in this study.
48 Ibid.

Cuba's External Economy

Background

The collapse of the Soviet Union in 1991 led to a severe economic crisis, which Havana refers to as the "Special Period in Time of Peace" *(período especial en tiempo de paz)*. In 2014 the average wage was still just 28 percent of the level achieved when Cuba was a member of Comecon.[49] By the early 1990 there was no alternative to a restructuring of Cuba's economy and trade, which until then had concentrated principally on exporting sugar, minerals and citrus fruit in the scope of the socialist division of labour.[50] In order to fund the imports it required – above all food and fuel – Cuba had to earn hard currency from new partners in the global markets. Two factors played an especially important role in this connection: relations with Venezuela and the deployment of medical teams in the scope of bilateral agreements.

The alliance between Havana and Caracas was initiated by Venezuelan President Hugo Chávez. Under an agreement from the year 2000, Venezuela supplied Cuba with 115,000 barrels of oil per day until 2016. Of these, 92,000 barrels went to domestic consumption, covering about 60 percent of demand.[51] The rest was refined and re-exported. It is estimated that the Venezuelan oil deliveries contributed between 12 and 20 percent of Cuban GDP.[52] In return, Cuba exported health and education services to Venezuela. This partnership represented an important driver of the economic growth Cuba has achieved since 2000. However, Venezuela's oil deliveries have been falling off since 2016, as the country faces grave economic difficulties of its own. In this situation, reducing dependency on Venezuelan oil has become a priority for the Cuban government. Amongst other things, Cuba plans to modernise and expand its own oil production with the help of Russian specialists, under an agreement with Russia concluded in 2014.[53] At the same time, Cuba is seeking to reduce its high economic dependency on Venezuela – which ultimately succeeded its earlier dependency on the Soviet Union. This is another reason why the guidelines aim to diversify the country's imports and exports.

Foreign trade is an important political and economic factor. In 2015 exports of goods and services accounted for 30 percent of GDP.[54] Cuba runs a large merchandise trade deficit, with exports worth $4.4 billion ($0.8 billion less than in 2014) as against imports estimated at $15.1 billion. Food and fuel imports are especially crucial for the Cuban economy, with strong import demand to date merely lowered by growth in the private-sector. While the private sector today accounts for 57 percent of food production while using only about 25 percent of the agricultural land,[55] about 80 percent of Cuba's food needs are still imported (for about $2 billion annually).[56] Ironically, a large proportion of the imports come from the United States,[57] which has exempted food from its embargo since 2000.

Cuba's inflated exchange rate has worsened its external imbalances in recent decades, by hampering exports and preventing import substitution. The guidelines identify merging the two different exchange rates as the central tool for reducing external imbalances. The details remain unclear, but the guidelines tie the measure to improvements in labour productivity. According to the party newspaper *Granma*, there is consensus that the Cuban peso (CUP) should be devalued against the US dollar and ultimately serve as

49 Whitefield, "Building the New Cuban Economy" (see note 15).
50 On the history of Cuba's external economy see Nancy A. Quiñones Chang, "Cuba's Insertion in the International Economy since 1990", in *Cuban Economists on the Cuban Economy*, ed. Campbell (see note 19), 89–113.
51 Antonio F. Romero G., "Los Desafíos de las Relaciones Económicas Externas de Cuba", *Cuban Studies* (University of Pittsburgh Press) 44 (2016): 133–61 (141).
52 "Cuba's Economy: Caribbean Contagion: Venezuela's Pneumonia Infects the Communist Island", *Economist*, 23 July 2016, 35.
53 "Russland hilft Kuba bei der Ölförderung und plant neuen Flughafen", *Cuba heute* (blog), 1 March 2015, https://cubaheute.wordpress.com/2015/03/01/russland-hilft-kuba-bei-der-olforderung-und-plant-neuen-flughafen/ (accessed 11 January 2017).
54 UNCTADSTAT, http://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/192/index.html (accessed 31 January 2017).
55 Sweig and Bustamante, "Cuba after Communism" (see note 17), 106.
56 IFAD, "UN Agency Head Visits Cuba" (see note 20).
57 Ibid.

the country's only currency. The government would like to see the rate move gradually towards CUP24/$1.[58] Currency adjustment appears to be occurring successively by sector.[59] The most frequently applied rate is CUP10/$1 for hotels and in the sugar and biotech industries; this corresponds to a 90 percent devaluation.[60]

However, such a sectoral approach is not only complicated and associated with considerable bureaucracy; it is also problematic because it creates new distortions within the economy. The World Bank therefore recommend unifying the two exchange rates at once and using subsidies and tax adjustments to neutralise the expected negative consequences – especially inflation.[61] The International Monetary Fund and the World Bank would normally support such a reform project, but that option is not open to Cuba. Although it was a founding member of the IMF in 1945, it withdrew in 1964 ahead of a decision to deny it access to funds. It had already withdrawn from the World Bank in 1960.[62] Progress towards merging the exchange rates has been very slow to date. The Economist Intelligence Unit, which was initially very optimistic over the prospects for Cuban reforms, now no longer believes that a single exchange rate will be in place by 2020, as it had originally forecast.[63]

Institutional framework: Trade as foreign policy

The actors, institutions and legal frameworks that define Cuba's trade flows differ strongly from those of a market economy. Under article 18 of the Cuban constitution of 1976 the state possesses a monopoly on foreign trade. The ultimate instance in this sphere is the Ministry of Trade and Foreign Investment (Ministerio del Comercio Exterior y la Inversión Extranjera, MINCEX). Foreign trade is conducted through state-licensed import-export companies. The number of such firms fluctuates: in 2003, following a period of expansion, there were almost five hundred operating actively. But the government subsequently withdrew numerous licences and tightened controls.[64] By 2005 there were just eighty-nine involved in foreign trade; since 2009 the scope and structure of imports has been determined by centralised planning mechanisms.[65]

Cuban imports are regulated by state instances, which make their decisions on the basis of political as well as economic considerations. Foreign firms interested in exporting to Cuba have to pass through a complicated approval process before being listed as a supplier by a licensed import company.[66] And even then, a series of factors influences whether orders are actually made. As well as the availability of hard currency, political objectives such as trade diversification also play a role. Germany Trade and Invest (GTAI) reports that Cuban companies that already enjoy good supplier relationships often have no interest in new vendors. To the chagrin of US businesses, state control also hampers trade between Cuba and the United States. Although new opportunities for US exports have arisen – for example through the Cuban state withdrawing from housing construction and the Obama administration permitting the export of construction materials, car parts and agricultural machinery to the Cuban private sector – the Cuban state import agency has authorised only one hundred import deals in this context. "I hoped that within a year there'd be a dozen export agents in Miami," one American official is quoted, "but we haven't really seen that."[67] This, he said, left Cuban importers dependent on the "Samsonite market" – anything that can be transported home in a suitcase.

Furthermore, the Cuban market often places special demands on products, such as ease of operation, resistance to power outage, or the possibility of maintenance by local workers. It is not always easy for high-technology suppliers from countries like Germany and

58 Pavel Vidal Alejandro and Omar Everleny Pérez Villanueva, *La Reforma Monetaria en Cuba Hasta el 2016: Entre Gradualidad y "Big Bang"* [Currency reform in Cuba until 2016: Between incremental development and "big bang"] (Washington, D.C.: Brookings and University of Havana, December 2013), 13.
59 Ibid., 14.
60 "Day Zero or D-Day? Cuba's Economy (2)", *Economist*, 16 May 2015, 42.
61 Augusto de la Torre and Alain Ize, *Exchange Rate Unification: The Cuban Case* (Washington, D.C.: World Bank, December 2013).
62 Gary Clyde Hufbauer and Barbara Kotschwar, *Economic Normalization with Cuba: A Roadmap for US Policymakers* (Washington, D.C.: Peterson Institute for International Economics, 2014), 63.
63 EIU, *Cuba: Country Report*, 14 July 2016, 2.
64 GTAI, *Tipps für das Kubageschäft*, 9, http://www.havanna.diplo.de/contentblob/4152386/Daten/5369430/tipps_fuer_kubageschaeft.pdf (accessed 11 January 2017).
65 Chang, "Cuba's Insertion in the International Economy since 1990" (see note 50), 100f.
66 GTAI, *Tipps für das Kubageschäft* (see note 64), 10.
67 "Lots of Diplomacy, Not Many Dollars", *Economist*, 12 December 2015.

the United States to satisfy such criteria.[68] This makes Cuba an especially interesting market for exporters from developing countries, which face similar conditions in their home markets and are therefore better positioned to meet such expectations.

Cuba's membership of the World Trade Organisation defines a basic institutional framework. In 1947 Cuba was among the first signatories of the General Agreement on Tariffs and Trade (GATT), the precursor of the WTO.[69] Imports are subject to the external tariffs notified to the WTO. 31.5 percent of Cuba's tariffs are bound, in the sense of a commitment under WTO law not to increase them. This puts Cuba below the average for developing countries, which is 73 percent (developed countries 99 percent). Cuba's highest bound tariff is 62 percent, the highest actually applied tariff 30 percent.[70] But because state instances regulate imports under a range of different criteria, the economic management function of tariffs is very much weaker than in the case of market economies. Although the WTO principles of non-discrimination and most favoured nation apply in Cuba too, they encounter limits in a socialist system where the state directs imports and selects ("discriminates") according to political criteria.

However, state import management can also make the Cuban market especially attractive in particular constellations. Cuba is a relatively small economy with a limited import volume, but since state-run companies normally concentrate imports in comparatively large orders, it can be very attractive to individual foreign suppliers. In fact, German suppliers that have succeeded in establishing themselves in the market have "secured orders in Cuba that set company records on a global scale".[71] So in certain cases firms may benefit from the state system of import regulation. But its overall effect is to make Cuba an unpredictable market.

Bilateral and regional agreements concerning trade

As well as being anchored in the WTO, Cuba's trade relations are embedded in a web of bilateral and regional agreements. Unlike in market economies, the function of these agreements is not in the first place to set a framework for the activities of individual firms. Instead they serve to pursue foreign policy objectives, to which economic policy goals are generally subjugated. A special role is occupied by Cuba's membership in ALBA (the Bolivarian Alliance for the Peoples of Our America), which was founded in January 2004 by Hugo Chávez and Fidel Castro as a platform for advancing the integration of its member states, inspired by the ideas of the freedom fighters Simón Bolívar and José Martí. But that should not be understood as meaning economic integration within a free trade area, as defined in international trade law. Instead, ALBA regards itself as an anti-imperialist, anti-neoliberal and anti-capitalist counter-movement to the Free Trade Area of the Americas proposed by Washington but not yet brought into being. As well as its two founding members, the Alliance currently comprises Antigua and Barbuda, Bolivia, Dominica, Ecuador, Grenada, Nicaragua, Saint Lucia, Saint Vincent and the Grenadines, and Saint Kitts and Nevis. According to its objectives,[72] ALBA deals with trade, but not in the sense of full reciprocal market opening. Instead, it promotes cooperation between members in particular sectors, especially energy and infrastructure.[73] ALBA offers an umbrella structure for bilateral sectoral cooperation agreements between member states, such as the Cuban-Venezuelan arrangements for oil deliveries and medical services.

Cuba has only notified two agreements to the WTO relating to free trade objectives.[74] The first is the Latin American Integration Association (LAIA or ALADI), which Cuba joined in 1999; its other members are Argentina, Bolivia, Brazil, Chile, Ecuador, Colombia, Mexico, Panama, Paraguay, Peru, Uruguay and Venezuela. LAIA aims to foster trade preferences between its members.[75] Cuba's second notified agreement is a partial scope agreement with El Salvador.

In the spirit of international socialist solidarity, Havana has always placed great weight on relations with developing countries. Cuba's prestige and inter-

68 GTAI, *Tipps für das Kubageschäft* (see note 64), 10.
69 WTO, *Cuba and the WTO*, https://www.wto.org/english/thewto_e/countries_e/cuba_e.htm (accessed 4 April 2016).
70 WTO, ITC and UNCTAD, *World Tariff Profiles 2014*, https://www.wto.org/english/res_e/booksp_e/tariff_profiles14_e.pdf (accessed 11 January 2016).
71 GTAI, *Tipps für das Kubageschäft* (see note 64), 7.
72 "[P]olitical, economic, and social alliance in defence of independence, self-determination and the identity of peoples comprising it", Alba Info website, http://albainfo.org/what-is-the-alba/ (accessed 4 April 2016).
73 Chang, "Cuba's Insertion in the International Economy since 1990" (see note 50), 98.
74 WTO, http://rtais.wto.org/UI/PublicShowMember RTAIDCard.aspx?rtaid=881 (accessed 1 April 2016).
75 ALADI, http://www.aladi.org/sitioAladi/quienesSomos.html (accessed 4 April 2016).

national influence have been boosted especially by its provision of medical services, including rapid aid for Haiti after the 2010 earthquake and for West Africa during the Ebola crisis of 2014/2015.[76] The terms of such support are set out in bilateral agreements, which Cuba has with Algeria, Angola, China, Qatar and South Africa. They cover the export of health services, and to a lesser extent also training; in the case of Angola and Qatar they also include advisory services in the field of sport.[77] Medical training for foreign students at Cuban universities is also an important element of Cuban co-operation with third countries. To date Cuba has trained about 50,000 students from 120 countries; more than 20 percent of them came from Latin America and the Caribbean.[78]

As well as the great importance of ALBA, the revised 2016 version of the guidelines underlines the strategic objective of expanding economic integration with Latin America and the Caribbean (paragraph 86f.). Cuba is connected within the Caribbean region through a series of institutions. The thirty-two-member Association of Caribbean States (ACS) was founded in 1994 to strengthen the Caribbean region. Its original concept of sectoral cooperation tallied with Cuba's general approach, and led to joint initiatives in areas like sustainable tourism, energy, maritime transport and higher education. However, the ACS action plan for 2016–2018 goes further and proposes establishing a working party to study the possibilities for trade preferences in the Greater Caribbean.[79] This can be viewed as a purely long-term project, not only because economic change in Cuba is a very slow business. The smaller Caribbean states are also likely to be very cautious concerning further trade liberalisation in the region, because they fear the competition advantages of larger ACS members like Mexico and Colombia. This reluctance towards integration with larger partners was already visible during the implementation of the Economic Partnership Agreement (EPA) between the European Union and the CARIFORUM region: the smaller Caribbean states in particular hesitate to apply the trade liberalisation agreed in the EPA to the Dominican Republic.[80] In view of the broader membership of the ACS, the prospect of rapid progress on reciprocal market opening is even less likely.

Cuba is not a party to the Caribbean EPA, but it is a participating state in CARIFORUM, which was established with the support of the European Union. CARIFORUM originally served as a coordinating body for European development funds for the Caribbean Community (CARICOM), then as the coordinator of the CARICOM and Dominican Republic side in the EPA talks. In the process, it has also become a go-to forum for exchange between the Caribbean Community and the Dominican Republic. Today CARIFORUM serves the implementation of the Caribbean EPA.[81] Cuba's ties with CARICOM itself are even closer, and are rooted in long-standing political links between the countries involved. The members of CARICOM were among the first states to recognise Cuba after the revolution, and opened formal relations despite strong pressure from the United States not to do so. For CARICOM Cuba is a major contributor of training programmes in fields such as medicine and health, sport, agriculture, trade and tourism.[82] Cuba educates many of the region's doctors; between 2014 and 2016 alone, eight hundred Guyanese students came to study medicine.[83]

Negotiations on updating the Trade and Economic Cooperation Agreement between Cuba and CARICOM were concluded in March 2017. The agreement aims to promote and facilitate trade in goods and services and to encourage and protect investments. At the same time, it creates a basis for wider joint activities in many sectors, as well as creating an institutional framework for

76 Francisco López Segrera, *Cuba-EEUU: De Enemigos Cercanos a Amigos Distantes (1959–2015)* [Cuba and the EU: From close enemies to distant friends (1959–2015)] (Barcelona, 2015), 58.
77 Ricardo Torres Pérez, "Structural Problems and Changes in Cuba's Economic Model", in *No More Free Lunch*, ed. Brundenius and Pérez (see note 2), 5–22 (12).
78 Luis Suárez Salazar, "Cuba's Foreign Policy and the Promise of ALBA", NACLA website, n. d., https://nacla.org/article/cubas-foreign-policy-and-promise-alba (accessed 28 November 2016).
79 Ministry of Foreign Affairs of Cuba, *Plan of Action for 2016–2018*, http://www.minrex.gob.cu/en/plan-action-2016-2018 (accessed 7 June 2016).
80 Evita Schmieg, *Trade and Investment Agreements for Sustainable Development? Lessons from the EU's Economic Partnership Agreement with the Caribbean*, SWP Research Paper 2015/06 (Berlin: Stiftung Wissenschaft und Politik, July 2015).
81 Caribbean Community Secretariat, *What Is CARIFORUM?* http://www.caricom.org/jsp/community_organs/cariforum/cariforum_main_page.jsp?menu=cob (accessed 17 March 2016).
82 "Cuba is now considered, by far, the largest contributor among Caricom's international partners." From "Cuba a Critical Partner to CARICOM, Says Brantley", interview with Mark Brantley, *Regional News*, 14 December 2015, http://caricom.org/media-center/communications/news-from-the-community/cuba-a-critical-partner-to-caricom-says-brantley (accessed 8 June 2016).
83 Interview with Percival Marie, director general of CARIFORUM, 5 December 2015.

ongoing dialogue.[84] The agreement's update now forsees improved market access for a range of products, including pharmaceuticals exported from Cuba and beer, fish, and agricultural products from CARICOM.[85] The governments of the Caribbean states regard Cuba as the partner they need to complete the ongoing political and economic integration of the region – as laid out in CARICOM's founding treaties.

The Caribbean states naturally hope to benefit from closer integration with Cuba, with which they are already politically connected. But they also worry over Cuba's growing economic weight; the smaller island states in particular fear further marginalisation through growing competition from their larger neighbour.[86] The Caribbean governments expect Cuba's economy to strengthen and its regional competition to sharpen in certain areas. This applies not only to trade in goods such as rum, sugar and other agricultural products, but also to tourism. They therefore also see Cuba's increasing opening to foreign trade as a spur to improve their own competitiveness.[87] Analysis of the Cuban reforms and their impact, on the other hand, suggests that major economic change will come about slowly, if at all, and the other countries in the region will therefore have time for adjustment processes.

Cuban economists tend to criticise regional integration agreements based on trade liberalisation as neoliberal instruments. But at the same time they see deepening of the joint Caribbean market as an opportunity to become more independent of the North American market.[88] In general free trade agreements are today regarded as an important means for securing preferential access to other markets as a means of expanding Cuba's own exports.[89]

Current situation in trade in goods

One major goal of the guidelines for updating Cuba's economic model is to increase and stabilise export revenues (paragraphs 76 and 77). Great emphasis is placed on diversifying exports, substituting imports and generally improving the external economic situation. High-value exports are regarded as especially desirable.[90] In this connection the guidelines also propose developing a strategy for expanding service exports, with particular attention to technological aspects (paragraph 80). This is concretised in the revised 2016 version of the guidelines in terms of concentration on export of professional services (paragraph 69). In this way it is hoped to expand opportunities for existing skilled workers. Suitable sectors in which Cuba's achievements are internationally recognised include biotech, medical and pharmaceutical products, software, nanotechnology, and scientific and technological services.[91] Exports of health services are also to be stepped up (paragraph 70).

In fact, Cuba's export revenues in 2015 – $4.4 billion – were lower than in 2010; in comparison to the two previous years they fell by about 15 percent.[92] Manufactured goods contribute 38 percent of exports, with pharmaceuticals playing a prominent role. Food accounts for 30 percent, most of which is accounted for by just three products: sugar, tobacco and rum. Fuel represents 11 percent, part of which is re-exported Venezuelan oil. In terms of minerals, nickel ore alone

84 "Trade and Economic Co-Operation Agreement between the Caribbean Community (CARICOM) and the Government of the Republic of Cuba", available at UNCTAD, http://investmentpolicyhub.unctad.org/Download/TreatyFile/2498 (accessed 6 June 2016).
85 CARICOM, "Cuba Agrees to Extension on Trade Agreement with CARICOM", CARICOM website, 14 March 2017, http://caricom.org/media-center/communications/news-from-the-community/cuba-agrees-to-extension-on-trade-agreement-with-caricom (accessed 30 March 2017).
86 "Will Cuba Change Caricom?" editorial, *Jamaica Observer*, 5 July 2015, http://www.jamaicaobserver.com/editorial/Will-Cuba-change-Caricom- (accessed 17 March 2016).
87 CARICOM, "Caribbean Tourism Stakeholders Say Cuba Is the Regions's Wakeup Call", 13 August 2015, http://caricom.org/media-center/communications/news-from-the-community/caribbean-tourism-stakeholders-say-cuba-is-regions-wakeup-call (accessed 30 November 2016).
88 Laneydi Martínez Alfonso, "Retos Actuales de la Integracíon en América Latina y el Caribe" [Current challenges of Latin American and Caribbean integration], *Temas de Economía Mundial* (Havana: Centro de Investigaciones de la Economía Mundial), no. 15 (2009): 81–97 (94).
89 Ricardo Torres Pérez, "Los Cambios Económicos en Cuba y su Posible Influencia en el Comercio con América Latina y el Caribe" [The economic transformation in Cuba and its possible effects on trade with Latin America and the Caribbean], in *Cuba y América Latina: Impacto de las Reformas en el Comercio de Bienes y Servicios* [Cuba and Latin America: Impact of the reforms on trade in goods and services], ed. Miriam Fernández and Omar Everleny Pérez Villanueva (Barcelona and Buenos Aires, 2013), 11–34.
90 VI Congreso del PCC, *Lineamientos* (see note 9), 8, 17.
91 Pérez, "Structural Problems and Changes in Cuba's Economic Model" (see note 77), 18.
92 Unless otherwise indicated, all data from UNCTADSTAT, http://unctadstat.unctad.org/CountryProfile/GeneralProfile/en-GB/192/index.html (accessed 31 January 2017).

represents about 13 percent of exports. While Cuba's foreign trade is no longer completely dependent on raw materials, diversification into non-traditional products has been slow to date; successes include medical, pharmaceutical and biotechnological products, machinery, and transport equipment.

The composition of the countries receiving Cuban exports has undergone a series of transformations since the collapse of the Soviet Union. In 2000 the EU was the main destination with 35 percent of exports, followed by Russia (18 percent) and Canada (17 percent). In 2014 Venezuela topped the list with 32 percent, but its share fell in 2015 to 25 percent, closely followed by the EU (21 percent), Canada (16 percent) and China, whose 15 percent puts it almost on a par with Canada. Although Russia is now almost irrelevant (with 1.4 percent), it has in the meantime forgiven 90 percent of Cuba's debts, with an option to convert the remaining 10 percent into Russian stakes in Cuban enterprises.[93] This will not only put trade on a new footing but also enable broader ties between the two economies. Other countries have also grown considerably in importance as recipients of Cuban exports, with Belize, Ghana, Dominican Republic and Brazil all exceeding 8 percent in 2015. Canada, as the second-largest trade partner, is at the same time the largest source of tourists, the second-largest supplier of public development aid and a significant originator of foreign direct investment, above all through Sherritt International's nickel-mining joint venture.[94]

Cuban imports in 2015 reflect an elevated dependency on Venezuela (34 percent compared to 22 percent in 2000), followed by the EU with 28 percent and China with 12 percent. China's role as a cooperation partner has grown considerably across the board. It supplies industrial products such as buses, televisions and refrigerators on low-interest loans, and has therefore become an important lender. China is also interested in Cuba's mineral reserves, principally importing nickel and cobalt. In return, Cuba shares its biotech and pharmaceutical production know-how with China,[95] and is a dialogue partner on the topic of developing a socialist market economy.[96]

Against this backdrop, the diversification of trade partners proposed in the guidelines (paragraph 78) remains important. In particular, Cuba would like to reduce its reliance on re-exporting Venezuelan oil for hard currency revenues. But export successes will require fundamental obstacles to be addressed through reforms. A series of deficits will need to be tackled before Cuban production and productivity can be expanded:[97] poor physical infrastructure, complicated customs and transport systems, high costs and/or lack of production-relevant inputs, and a complex regulatory environment. The Cuban economist Ricardo Torres Pérez also emphasises the importance of access to credit to fund the necessary infrastructure investments. This problem is exacerbated by Cuba's exclusion from World Bank loans, which would be available to other countries in comparable situations.[98]

For all these reasons it must be assumed that Cuba will be unable to compete in the global market on the basis of advantages of scale or cost. Instead it must seek its edge in very specific sectors reliant on education and research, such as pharmaceutical and biotech products.[99] In order to develop its biotechnology sector, Cuba is collaborating above all with other developing countries, especially Venezuela; at the same time it also operates as an investor, for example in China.[100] But Antonio Gómez of the University of Havana criticises that the medical/pharmaceutical and biotech sectors are the only high-technology fields with demonstrable scientific and economic worth.[101]

In view of the circumstances and obstacles, it is likely to remain very difficult for Cuba's export sector to achieve the goals it has been set: diversifying export structure and destination and expanding exports and their value content.

The Cuban economy is highly import-dependent. A large proportion of its food and fuel needs have to be imported, while its ability to balance its trade through exports of goods has deteriorated steadily since about 2000. In this situation, the trade deficit was one of the significant factors spurring the development of a new economic model; the merchandise trade balance has

93 Segrera, *Cuba-EEUU* (see note 76), 56.
94 Ibid.
95 Elmar Kulke, "Die Entwicklung der Wirtschaft in Kuba", in ibid., *Kuba – Auf Tour* (Heidelberg, 2011), 47.
96 Segrera, *Cuba-EEUU* (see note 76), 56.
97 Pérez, "Los Cambios Económicos en Cuba" (see note 88), 17.
98 Ibid., 25ff.
99 Miriam Fernández, "Circunstancias que Inciden en el Acceso a los Mercados de Países de América Latina: Costos de Entrada y Competencia para las Empresas Cubanas" [Circumstances with effects on access to the markets of Latin American countries: Competitivemess of and access costs for Cuban companies], *Cuba y América Latina*, ed. Fernández and Villanueva (see note 88), 115–36 (132).
100 Richard E. Feinberg, *The New Cuban Economy: What Roles for Foreign Investment?*, Washington, D.C.: Latin America Initiative at Brookings, December 2012.
101 Romero G., "Los Desafíos" (see note 51), 138.

improved since 2009, although it still remains negative.[102]

The negative merchandise trade balance is made up by remittances and service exports. Most of the $5.1 billion annual remittances originate from the United States. The total is likely to rise rapidly, now that Washington has raised the limit from $500 to $2,000 per quarter and person or institution (and abolished it entirely for payments to humanitarian projects and private businesses).[103] Remittances exert great influence on the dynamics of the Cuban economy, because they represent a source of funding for many of the self-employed.

The importance of services in Cuban exports has expanded rapidly over the past fifteen years, to a point where they now outstrip exports of goods. Services have grown from 10 percent of total exports in 1990 to 70 percent since 2005.[104] Within the WTO framework, the General Agreement on Trade in Services (GATS) defines four modes of service provision: cross border trade (for example in insurance services), consumption abroad (for example tourism), commercial presence through investment (such as opening a hairdressing salon), and provision by a natural person working abroad (for example a doctor). By far the most important service exports for Cuba are tourism (mode 2) and temporary migration of medical workers (mode 4). These are discussed in greater detail below.

The growing importance of tourism

Tourism already acquired an important function in the so-called Special Period following the collapse of the Soviet Union, when trade with the socialist bloc evaporated and it was urgently necessary to generate hard currency for vital imports. The number of annual visits passed the one million mark in 1997, and by 2004 there were more than two million, making Cuba the third-placed tourism destination in the Caribbean.[105] In 2016, according to the Cuban Tourism Ministry, more than 3.7 million people visited the country, with 4.1 million expected in 2017. Interestingly, the proportion entering on cruises is much smaller than in other Caribbean countries (just 1 percent). This type of tourism is generally associated with very low domestic value added.

The number of visitors from the United States has grown especially strongly, with 77 percent growth in 2015 alone. But great potential for growth still remains. In February 2016 the United States and Cuba agreed to resume regular direct flights between the two countries, which is likely to further increase the numbers of US visitors.[106] Although US citizens must in theory belong to one of twelve categories in order to obtain permission to visit Cuba, they no longer need to apply for a licence, making the travel restrictions irrelevant in practice. In 2015 Cuba earned more than $2.8 billion from tourism.[107] The most important countries of origin are currently Canada with 41.6 percent, Italy with 5.6 percent, Germany with 5.1 percent and France with 4.6 percent; Italy, Spain and Poland exhibit the strongest growth rates (January 2015 year-on-year).[108]

With tourism Cuba has tapped a significant source of hard currency, which has in fact exceeded the value of goods exports since 1998.[109] But it is also viewed as a threat to socialist achievements by contributing to class differentiation and inequality, because those who work in the tourism industry receive direct access to hard currency.[110] Further negative effects are expected, such as an increase in drug consumption and prostitution which are judged as incompatible with socialist values. Moreover, surveys show that the Cuban population fears that foreign visitors could squeeze

102 Ibid., 134.
103 Jennifer M. Harris, "The Winners of Cuba's 'New' Economy" (commentary), *Fortune*, 14 January 2015, http://fortune.com/2015/01/14/the-winners-of-cubas-new-economy/ (accessed 31 March 2016).
104 Oscar U-Echevarría Vallejo, "The Evolution of Cuba's Macroeconomy: From the Triumph of the Revolution through the Special Period", in *Cuban Economists on the Cuban Economy*, ed. Campbell (see note 19), 62–88 (73).
105 Miguel Alejandro Figueras, "The Evolution of International Tourism in Cuba", in *Cuban Economists on the Cuban Economy*, ed. Campbell (see note 19), 235–51 (242).
106 EIU, *Cuba: Country Report*, March 2016 (see note 6).
107 Katheryn Felipe González, "Cuba's Dynamic Tourist Sector in 2016", *Granma*, 14 December 2016, http://en.granma.cu/tourism/2016-12-14/cubas-dynamic-tourist-sector-in-2016 (accessed 27 January 2017).
108 La Oficina Nacional de Estadística e Información (ONEI), *Turismo: Llegada de Visitantes Internacionales* [National Statistics and Information Agency, Tourism: International arrivals], March 2016, http://www.one.cu/publicaciones/06turismoycomercio/llegadadevisitantes/mensual/3.pdf (accessed 4 April 2016).
109 Alfredo Garcá Jiménez, "Tourism: Natural Product, Source of Exchange with the Outside World, and Ideological Challenge", in *Cuban Economists on the Cuban Economy*, ed. Campbell (see note 19), 252–69 (262).
110 Ibid., 266.

out domestic tourism. The government is actively addressing this worry at least, by expanding provision for Cuban holidaymakers. The guidelines also include corresponding targets. So the expansion of tourism is highly welcome, but also watched with scepticism.

Another development in this area is also a double-edged sword: the growing numbers of highly qualified workers moving to the rapidly growing tourism sector, with fifteen thousand university graduates reportedly having left their original professions to do so.[111] While Cuban economists see this as one cause of the strong productivity growth in this branch, it also means that existing qualifications are not being used truly efficiently.

Cuba has, however, succeeded – partly through a deliberate policy – in leveraging tourism for local value and job creation,[112] which are preconditions for this sector to contribute to economic growth and social development. The connection arises above all through the supply of goods for tourism purposes; principally food, but also craft products. But the fundamental limitations of the Cuban economy make it difficult to expand agricultural deliveries to hotels. The decision to permit farmers to sell their products directly to hotels at an exchange rate of CUP10/$1 has not had the expected effect of significantly increasing direct deliveries from Cuban agricultural producers. While the local share of products supplied to the tourism sector has grown from 12 percent in the early 2000s to about 68 percent today,[113] non-agricultural products must largely account for the increase. Tourism can also create demand for services such as music, sport and gastronomy. Two thousand music groups with a total of eleven thousand members are associated with the Cuban tourism sector.[114] The guidelines therefore place great importance on strengthening relations between tourism and the local economy.[115] But like other sectors, tourism will only be able to achieve its full potential – above all for contributing to increased value added – once restrictions in related areas, especially agriculture, have been overcome.

Foreign deployment of medical personnel

Foreign deployment of Cuban medical personnel is not only a pillar of political cooperation, but has also become an important source of hard currency. In economic terms this represents a service export in GATS mode 4. However, the Cuban medical personnel sent within the Bolivarian Alliance (ALBA) – above all to Venezuela – are officially declared not as a service export but as cooperation to mutual advantage outside the logic of capitalist trade.[116] The precise number of Cuban medical staff working abroad is unknown, but is estimated at 30,000 to 50,000.[117] The total annual revenue is reportedly about €4.6 billion, making it the country's most important source of hard currency ahead even of tourism.[118]

However, exporting medical services has transpired not to be entirely unproblematic for Cuba. A (small) proportion of those involved defect and fail to return – even though the arrangements are designed to prevent precisely that. While on deployment, personnel receive only a small proportion of the "fee" paid by the host country. Most of it is deposited in a hard currency account in Cuba that they can only access after their return – and not until they have completed the entire agreed period of service. According to Solidaridad sin Fronteras, a Miami-based doctors' organisation, the Cuban government keeps up to 93 percent of the currency revenues received for medical work.[119]

Migration to the United States has been facilitated by an American initiative of 2006, the Cuban Medical Professional Parole Program under which Cuban doctors receive a residence permit for the United States.[120] In 2014 1,278 Cuban doctors emigrated to the United States under this programme.[121] In 2015 unauthorised

111 Figueras, "The Evolution of International Tourism in Cuba" (see note 105), 243.

112 Romero G., "Los Desafíos" (see note 51), 151.

113 Figueras, "The Evolution of International Tourism in Cuba" (see note 105), 244.

114 Miguel Alejandro Figueras and Yanedy Pérez Cárdenas, "Competitividad del Destino Turístico Cuba: Impacto Económico" [Cuba's competitiveness as a tourist destination: economic effects], *Economía y Desarrollo* 153 (2015): 178–89 (184).

115 VI Congreso del PCC, *Lineamientos* (see note 9), 33.

116 This is demonstrated very clearly in the argumentation of Cuban Professor Suárez Salazar, see Salazar, *Cuba's Foreign Policy* (see note 78).

117 Hufbauer and Kotschwar, *Economic Normalization with Cuba* (see note 62), 30.

118 Matthias Rüb, "Gestrandet in Bogotá", *Frankfurter Allgemeine Zeitung*, 25 August 2015.

119 Ibid.

120 Ibid.

121 EIU, "Cuba: Government Takes Steps to Stem Migration of Doctors", 9 December 2015, http://country.eiu.com/article.aspx?articleid=1803750164&Country=Cuba&topic=Economy (accessed 14 March 2016).

emigration of Cuban doctors to the United States almost doubled, to about 43,000.[122] In December 2015, in response to this brain drain, Havana reversed its decision of 2013 to abolish the exit visa requirement for doctors, because emigration was causing serious difficulties for the domestic health system.

While temporary migration of medical staff plays an important role in generating hard currency, it does nothing to promote value creation or social development within the country. Because the involved experts provide their services abroad, they are largely unconnected to other sectors at home. So apart from the currency revenues themselves, stimuli for dynamic development cannot be expected from this quarter.

Cuba has considerably expanded its hard currency revenues through tourism and medical services, and to that extent succeeded in fulfilling its economic plan. In view of the inadequacy of the data, it is hard to assess the extent to which this has contributed to the country's development. The Cuban economist Pedro Monreal González questions whether what he calls the country's "dual model" is any better than having fundamentally closer ties to the world economy.[123] The expansion of exports – including services – sought under the guidelines requires the development of further export-capable service sectors; areas offering high productivity and potential to improve economic efficiency, such as production-related services, are thus particularly sought-after. However, the development of such services requires different infrastructure than production and trade in goods, for example telecommunications, information technology, and air travel. These are areas where Cuba lags well behind international standards.[124] Incoherent political decisions relating to significant factors therefore also hamper the expansion of production and export of services.

Altogether the Cuban trade sector is far from achieving its goals of increasing exports and diversifying trading partners to contribute to sustainable development and diminish dependency on Venezuelan oil. Cuba has enjoyed only limited success in linking its exports with growing domestic value creation and employment as a contribution to sustainable development. An important role is therefore attributed to foreign direct investment, not only for the influx of capital and technology but also for diversification of exports.[125]

Foreign direct investment

Cuba's sixty bilateral investment agreements encompass most European countries, including Spain (1994), Germany (1996) and France (1997); twenty agreements have been signed but are not yet in force.[126] These agreements regulate fundamental questions such as non-discrimination (vis-à-vis domestic companies), compensation in event of expropriation, free transfer of capital and dispute settlement. As such, they create a legal framework for investment, but without the instrument of investor-state dispute settlement, which is included in most other bilateral investment agreements but has come to be seen as highly controversial. In a socialist economy it is also hard to imagine foreign investors being granted the right to take the government to court. Accordingly, Cuba's agreement with Germany – unlike many other German investment protection agreements – provides only for a tribunal to convene on a case-by-case basis.[127]

Investments in services also fall under the WTO's services agreement (GATS), under which Cuba grants its WTO partners access to its own markets. Foreign stakes in joint ventures are limited to a maximum of 49 percent, but the authorities may permit a larger share in specific cases.[128]

The question of foreign direct investment is a priority in the guidelines of 2011 and the 2016 revision. The documents tie acquisition of foreign direct investment to concrete objectives such as access to modern technologies, export diversification, import substitution, job creation and securing the provision of food and basic goods to the Cuban population, as well as access to foreign markets through joint ventures. Particular emphasis is placed on diversifying the countries of origin.[129] The revised 2016 version of the guide-

122 Ibid.
123 Pedro Monreal González, "Cuba and the Challenges of Globalization" (commentary), in *Cuban Economic and Social Development*, ed. Domínguez et al. (see note 21), 227–36 (231).
124 Pérez, "Los Cambios Económicos en Cuba" (see note 88), 28.
125 Romero G., "Los Desafíos" (see note 51), 145.
126 UNCTAD, *Investment Policy Hub: Cuba*, http://investmentpolicyhub.unctad.org/IIA/CountryBits/52 (accessed 6 June 2016).
127 "Vertrag zwischen der Bundesrepublik Deutschland und der Republik Kuba über die Förderung und den gegenseitigen Schutz von Kapitalanlagen", 30 April 1996, *Bundesgesetzblatt*, Teil II, no. 14 (4 May 1998): 747–53.
128 GATS, *Republic of Cuba: Schedule of Specific Commitments*, GATS/SC/24, 15 April 1994.
129 VI Congreso del PCC, *Lineamientos* (see note 9), 19.

lines underlines foreign direct investment as an important development stimulus.

A new investment law (Ley de Inversión Extranjera) came into force in June 2014, substantially altering access for foreign direct investment in certain fields. While the new law permits foreign companies to invest in all sectors apart from health, education and the military, in practice the principal exclusions are the sugar and biotechnology industries. The investment law grants foreign investors certain guarantees (no expropriation without compensation) and numerous tax breaks.[130]

In a break with prior tradition, purely foreign companies may now operate independently (rather than being limited to stakes in joint ventures). But such investments must be approved by Cuba's highest administrative organ, the Council of Ministers. Moreover, purely foreign companies cannot enjoy the tax breaks, not even in the Special Development Zone Mariel.[131] In autumn 2014 the government put out to tender 246 projects with a total volume of $8.7 billion for foreign investment.[132] They span practically all sectors, including twenty-one new hotels, renewable energy (including wind farm projects with 100 percent foreign ownership) and consumer products such as shoes and glassware. But to date there is no purely foreign company operating in Cuba.[133]

The activities of the online accommodation service Airbnb suggest that hard currency is one of Cuba's central motivations for permitting foreign direct investment. Since 2015 Airbnb has been using the accommodation system run by Casas Particulares, the state agency supplying private rooms to tourists.[134] Given the rapid growth in both visitor numbers and rooms offered this is likely to be a highly profitable business. It is not immediately obvious in this case why the Cuban state has relinquished its monopoly to a foreign private company – in an area based largely on human capital that Cuba was previously plainly able to run on its own. One possible explanation is Havana's great interest in acquiring access to hard currency.

Foreign direct investment already plays a role in important sectors today. Thus there are about 250 joint ventures; the most important countries of origin are Spain, Italy, Canada and Venezuela, the principal sectors tourism (where for example the Spanish hotel chain Sol Meliá is active), oil and energy.[135] But foreign firms are also active in other economically and politically important areas. Canadian Sherritt International, for example, holds a 50-percent stake in a nickel-mining joint venture. Imperial Tobacco is involved in distribution of Cohiba cigars, also with a 50 percent stake, while the French firm Pernod Ricard is involved with Havana Club rum. Nestlé, the world's largest food producer, holds 60 percent of Cuban ice cream manufacturer Coralac and 50 percent of mineral water supplier Los Portales. Unilever has a 50-percent joint venture with Cuban cosmetics manufacturer Suchel.[136]

As a study by political economist Richard Feinberg shows, foreign investors value Cuba for secure market share, its stable economic environment and the political "inclusion" of the trade unions. Notably, they are positive towards the lack of typical competitive aspects that make business strenuous in the market environment. Operating in socialism may be easier, but the flip side is seen where investors name the drawbacks: the state-directed recruitment and pay system, price controls constraining profitability, dependency on unreliable suppliers, and workforce loyalty issues.[137] The reason for the latter results is that workers have no direct contractual relationship with their employer, only with the Cuban state.

The guidelines for updating the economic model also formed the basis for creating the Special Development Zone Mariel, through Law No. 313 of September 2013. Brazil supported the project through its development bank BNDES, with a loan covering almost two-thirds of the total costs of $900 million; and the Brazilian company Odebrecht did the construction work.[138] The heart of the Special Development Zone is a deep-water port forty-five kilometres from Havana, whose first phase was inaugurated at the beginning of 2014. Through Mariel, Cuba hopes to establish itself as a

130 Romero G., "Los Desafíos" (see note 51), 148f.
131 GTAI, *Tipps für das Kubageschäft* (see note 64), 14.
132 Published on behalf of the state by the Centro para la Promoción del Comercio Exterior y la Inversión Extranjera de Cuba (CEPEC) [Cuban Centre for the Promotion of Foreign Trade and Investment].
133 GTAI, *Tipps für das Kubageschäft* (see note 64), 14.
134 Alexander Busch, "Kubas Öffnung: Die westlichen Investoren stehen Schlange", *Neue Zürcher Zeitung*, 24 May 2015.
135 Barbara Kotschwar and Cathleen Cimino, *Towards Economic Normalization with Cuba: A Roadmap for US Policymakers: Overview on Cuban Imports of Goods and Services and Effects of US Restrictions*, statement prepared for the US International Trade Commission Hearing No. 332-552, 2 June 2015.
136 Feinberg, *The New Cuban Economy* (see note 100).
137 Ibid., 58.
138 GTAI, *Tipps für das Kubageschäft* (see note 64), 15.

Caribbean transport node, leveraging its closeness to the Panama Canal and the United States. Firms operating in the Special Development Zone enjoy tax incentives and special arrangements for employment. Although, as usual in Cuba, workers must be employed through state employment agencies, these take less than the normal 90 percent as their fee.[139]

Generally, conditions for private foreign investment in Cuba have improved over recent years. As far as relations with the United States are concerned, it will not be enough to resolve the fundamental issue of the embargo; there is also great potential for business-to-business conflict. The dispute over the rum brand Havana Club represents a good example of the kind of problem that will need to be resolved if relations between the United States and Cuba are to improve further. "Havana Club" was registered as a Cuban brand in the United States in January 2016,[140] to the great displeasure of the formerly Cuban, now American firm Bacardi, which had hitherto been the sole supplier of Havana Club rum in the United States (albeit also labelled "Puerto Rican Rum"). Today "Havana Club" is produced in Cuba by the Franco-Cuban joint venture Cuba Ron/Pernod Ricard. Although Cuba and Pernod Ricard registered the trademark in the United States in 1976 and 1995 respectively, in 1997 Bacardi declared itself the rightful owner in the United States, citing its relationship with the inventor of Havana Club, José Arechabala. Under American trademark law, actual use of a brand plays a crucial role; the user becomes the legitimate owner. In 2012 the US Supreme Court ruled that the Cuban export firm Cubaexport had no right to register the brand with the US Patent and Trademark Office. But various US ministries subsequently engineered a new decision that fitted with the current policy of détente with Cuba. Bacardi for its part intends to defend its position.

Havana Club is just one example of the kind of private sector conflict that will have to be resolved in the wake of the Cuban-American rapprochement. Many companies that were nationalised during and after the revolution – especially those based in the United States – are simply waiting for the opportunity to sue for compensation; they include Coca-Cola, Exxon Mobil and Colgate-Palmolive. In the 1970s the US Department of Justice put the total compensation claim for six thousand cases at more than $1.8 billion (at today's value about $7 billion).[141] Cuba rejects these claims, and is instead seeking damages of $834 billion incurred through the US embargo and CIA attacks.[142] It is unlikely that Cuba will ever be willing or able to pay the compensation demanded. One possibility already discussed in the media would be to grant Cuban state licences, for example for mining, tourism or transport, to companies owed compensation. This would be similar to the option used to settle the remaining 10 percent of Cuba's debts to Russia.

Cuba's improving political and economic relations with the United States have fostered growing interest in investment there. And Washington's removal of Cuba from its list of countries supporting terrorism is also likely to facilitate trade financing. However, Germany Trade and Invest (GTAI) advises German firms against investing in Cuba, even with a majority stake, because of the lack of legal security.[143] Foreign partners have in the past often been forced out of joint ventures when Cuba's interests changed, despite formal guarantees. The risks are smaller in technologically advanced sectors, where Cuba is reliant on foreign know-how.

Numerous administrative obstacles contribute to the suboptimal conditions. These include employment rules, as well as protracted approval procedures and a generally low level of entrepreneurial freedom. Centralised state control of import and export licences opens the door for clientelism and creates risks for business. These factors explain why the number of foreign investments has receded since about 2005,[144] and why to date neither the investment law of 2014 nor the creation of Special Development Zone Mariel has increased the number of projects.[145]

If the Cuban government wishes to achieve a situation where foreign direct investment contributes to more dynamic development (of exports) it will also have to persuade SMEs to participate. As well as large-

139 Ibid.
140 On the following, see "Wem gehört Havana Club? Es geht um Geld, Macht – und die große Weltpolitik", *Frankfurter Allgemeine Zeitung*, 22 February 2016. Details to be found in Stephen J. Kimmerling, *Havana Club: A Case Summary and an Analysis of Selected Legal Issues*, Association for the Study of the Cuban Economy, http://www.ascecuba.org/c/wp-content/uploads/2014/09/v09-kimmerlg.pdf (accessed 30 March 2017).
141 Busch, "Kubas Öffnung" (see note 134).
142 "Lots of Diplomacy, Not Many Dollars: The Fruits of a Historic Year for the United States and Cuba", *Economist*, 12 December 2015.
143 GTAI, *Tipps für das Kubageschäft* (see note 64), 13, with further details on the possible legal entities for foreign engagement.
144 Romero G., "Los Desafíos" (see note 51), 145.
145 EIU, *Cuba: Country Report*, 11 June 2015.

scale projects, the list of tendered investment projects accordingly also includes ones within the scope of SMEs. There also needs to be a change in the framework to stimulate internal investment and a general strengthening of the economy through private-sector activity. In order to enhance economic growth, the Cuban economist Antonio Gómez recommends a clear distinction between entrepreneurial and state functions; transparent principles should represent the only restrictions that govern company decisions.[146] That shows that the internal debate within Cuba has also identified the fundamental problems of the country's economy.

The difficult circumstances for private-sector activities hinder the inflow of foreign direct investment. In connection with the investment law of 2014 the government hoped to attract $2.5 billion annually. That is the amount needed to achieve the desired economic growth of more than 5 percent.[147] Foreign direct investment is essential to achieve the development goals set out in the guidelines, to maintain and modernise existing industrial facilities, and to facilitate an expansion of exports and a diversification of production. Here the European Union is a very significant partner, not only on account of its economic weight but also as a technological leader in important sectors.[148]

146 Gómez, *Transformaciones Económicas* (see note 23), 22.
147 Juan Triana Cordoví, "Las Reglas del Juego" [The rules of the game], *On Cuba* (online), 24 October 2016, http://oncubamagazine.com/columnas/las-reglas-del-juego/ (accessed 25 November 2016).
148 Romero G., "Los Desafíos" (see note 51), 156.

Relations with the European Union

The Dialogue and Cooperation Agreement of 2016

As a relatively significant trade and investment partner, Europe has the potential to play an important role in the process of reforming the Cuban economy. The EU is Cuba's second-largest trading partner after Venezuela, which is currently fading rapidly. In 2016 Cuba exported goods worth €417 million to the EU.[149] Companies from EU member states are already major investors in Cuba, above all in the areas of tourism, construction, light industry and agriculture. About one-third of the island's tourists come from the EU. And Europe is also an important source of development funding. Between 2008 and 2014 the EU supplied about €90 million for development cooperation with Cuba, the priorities being agriculture and food security, environmental and climate protection, and supporting a sustainable economic and social modernisation.[150] On the other hand, Cuba is not of great economic significance for Europe. Its share of the EU's total external trade is just 0.1 percent, with exports of more than €2.0 billion in 2016, above all machinery and transport equipment, chemicals and manufactured goods.

The Political Dialogue and Cooperation Agreement initialled on 11 March 2016 after two years of negotiations creates a new framework for political and economic relations.[151] It succeeds the EU's Common Position of 1996,[152] which made full cooperation with Cuba conditional on progress on human rights and political liberties but did not exclude instruments of economic cooperation. The EU reduced mutual relations to a minimum in 2003, after seventy-five dissidents were detained. Not until 2008, after the release of political prisoners, was the relationship upgraded again.

Despite their Common Position, the EU member states developed widely differing stances towards Cuba. In view of the nineteen bilateral political declarations and memoranda of understanding between Cuba and individual EU states,[153] the Common Position ultimately lost its significance. According to the Latin America expert Günther Maihold, "in certain EU member states, Cuba policy was easily instrumentalised for domestic and ideological purposes"; finding a common position was also made more difficult by the historically rooted anti-communism in the eastern member states, which refused to cooperate with a totalitarian regime.[154] Against this backdrop the Dialogue and Cooperation Agreement of 2016 offers the EU an opportunity to reinstate a joint stance towards Havana. Cuba values the agreement for strengthening its international recognition, contributing to a diversification of cooperation partners, and establishing a firm framework for future economic and political relations.

The agreement contains three main areas: (1) political dialogue; (2) cooperation and sectoral dialogue; (3) trade and trade cooperation. On trade it goes no further than underlining the WTO principles of most-favoured treatment and non-discrimination and referencing WTO rules such as those on sanitary and phytosanitary measures, technical barriers to trade, and trade facilitation. The agreement contains little in the way of substance, and is not a free trade and investment agreement of the kind the EU has concluded with other partners. The two sides do not grant each other improved access to markets or for investments, and the EU enters into no new commitments. Its value is therefore above all political; it creates the basis for a regular dialogue and defines areas of cooperation.

149 European Commission, European Union, *Trade in Goods with Cuba*, http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_122460.pdf (accessed 30 March 2017).
150 European Commission, *International Cooperation and Development, Cuba*, https://ec.europa.eu/europeaid/countries/cuba_en (accessed 30 March 2017).
151 European Commission, "European Commission Proposes Political Dialogue and Cooperation Agreement with Cuba", press release, 22 September 2016.
152 EU, *Common Position of 2 December 1996 Defined by the Council on the Basis of Article J.2 of the Treaty on European Union, on Cuba* (96/697/CFSP), http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:31996E0697 (accessed 15 July 2016).
153 EEAS, *Joint Declaration at the Initialling Ceremony of the Political Dialogue and Cooperation Agreement between Cuba and the European Union* (Havana, 10 March 2016), http://eeas.europa.eu/statements-eeas/2016/160311_01_en.htm (accessed 13 March 2016).
154 Maihold, *Vom Sonderfall zur Normalisierung* (see note 44), 5.

In fact, "one of the most important motivations of European engagement is to get the Union's voice heard in Cuba and to accompany the expected governance discussions there".[155] Article 5 therefore provides for the establishment of a human rights dialogue, but the concrete topics are as yet undefined and this is a field where great differences exist between the parties. The agreement now creates the basis for a dialogue on issues such as freedom of speech and of the press, which would represent the beginnings of a normalisation of EU-Cuban relations. Previously, Cuba had been the only Latin American country without a trade or cooperation agreement with the EU.

The EU's trade policy provides no preferences for Cuba; the EU tariffs notified to the WTO apply. For a long time Cuba benefited from the EU's Generalised System of Preferences (GSP) for developing countries. But Cuba was removed from the GSP list after the World Bank classified it as "upper middle income" for three successive years on the basis of its high GDP. This impacted negatively on Cuban tobacco exports, where the tariff rose significantly.[156] The country's classification as upper middle income, as discussed above, is based on the official exchange rate of CUC1/$1. If the currency is devalued, as proposed in the guidelines, Cuba could once again benefit from European trade preferences under the EU's Generalised System of Preferences.

Fundamentally it would also be conceivable for Cuba to join the Economic Partnership Agreement between the EU and the CARIFORUM countries, which came into effect in 2008. At the same time this would also promote trade integration within the Caribbean region. But Cuba's socialist economic model and political principles mitigate against joining an agreement aiming to liberalise flows of goods and services on the basis of private contracts. Trade cooperation of that kind with Cuba is therefore unlikely to come into being in the near future.

Germany's interests and engagement

Germany's position towards Cuba has moved within the scope of the agreed basic European position. Although Germany completed negotiations on a bilateral cultural agreement with Cuba in 2003, it never came into effect because of the human rights situation.

On 16 July 2015, Cuba and Germany signed a joint declaration regulating the bilateral relationship and to that extent supplementing the EU-Cuba agreement.[157] It is initially valid for two years, but is extended automatically if not terminated by either side. Cuba values this agreement as a political signal for a normalisation of relations. It hopes for growing interest of German investors in the fields of agriculture, high-tech, renewable energy, and infrastructure; growth in tourism is also desired.[158] The declaration provides for cooperation in the fields of business, research, technology, education, culture and sport, as well as joint bilateral projects in third states. A political consultation mechanism is provided, including regular annual consultations at the level of director general. In fact, the exchange planned with Cuba is unusually close. The first bilateral consultations with any Latin American country were only held in 2015, namely, with Brazil (and here at ministerial level) which is considerably more important for Germany under aspects such as trade, investment and resources. Such strong engagement for little Cuba comes as something of a surprise.

German industry also appears to demonstrate strong interest in Cuba, even if the small market and difficult circumstances hardly justify this. In January 2016 German Economy Minister Sigmar Gabriel visited Cuba with a sixty-strong business delegation. He said he saw opportunities for German industry in medical technology, biotechnology, and energy, waste disposal and water.[159] Historically, German firms have already been involved in fields such as electricity and water supply, as well as restoration projects in Old Havana and the seafront promenade. The large number of business representatives accompanying the minister is an indication of the "gold rush" mood created by the reforms. It is planned to open a German business representation in Havana to promote trade and investment.[160]

155 Translated from ibid., 7.
156 Ibid.

157 Auswärtiges Amt, "Außenminister Steinmeier besucht erstmals Kuba", 18 July 2015, http://www.auswaertiges-amt.de/DE/Aussenpolitik/Laender/Aktuelle_Artikel/Kuba/150707_BM_besucht_Kuba.html (accessed 19 September 2016).
158 "'Kuba will keine Schocktherapie'. Bruno Rodríguez im Interview", *Süddeutsche Zeitung*, 12 May 2016.
159 Dana Heide, "Einsatz in Havanna: Wirtschaftsminister Gabriel ist in Kuba unterwegs", *Handelsblatt*, 8 January 2016.
160 Richard Bauer, "Kuba sucht sein Heil im ausländischen Geld", *Neue Zürcher Zeitung*, 11 January 2016.

Conclusion and Recommendations

The rapprochement between Cuba and the United States has reset the coordinates for the island state's external economic development by making it possible for Havana to normalise its relations with other states too; this includes closer trade relations and reciprocal direct investments. Various factors can already be observed having a positive effect on the Cuban economy and contributing to faster economic growth, including new trade relationships, higher remittances from the Cuban diaspora in the United States and strong growth in tourism. These trends boost the fundamentally positive expectations that governments and the private sector have concerning Cuba's prospects.

Cuba's active diplomacy, which also contributed to the 2016 Dialogue and Cooperation Agreement of 2016 with the EU, creates a basis for closer political exchange and expanded economic cooperation. This also applies to the industrialised nations, with which Havana has to date maintained only restricted relations on account of the American embargo. The high expectations for trade and cooperation that exist in the Cuban government, the partner countries and the private sector can, however, only be fulfilled under certain general conditions.

Germany and the EU must use the political dialogue to show Havana that the updated economic model can only attract sustained foreign direct investment if the conditions lastingly improve. One reason why investment in Cuba is seen as risky is its track record of frequent changes of political course. From the entrepreneurial perspective the existing framework – above all the strong sway of political/administrative instances and investors' restricted influence over recruitment and pay – incurs high costs that have to be redeemed. Foreign investors weigh up very carefully whether an investment will be worthwhile, especially in view of the small size of the Cuban market. Havana can only succeed in attracting more investment if the state's control over private-sector decisions is relaxed. Options such as administrative steering of investment and obligatory technology transfer are open to a country like China because investors are keen to engage on account of the enormous Chinese domestic market. Cuba, on the other hand, is so small that it will have to bend much more strongly to international conditions if it is to become an attractive investment location in the long-term.

The EU should not push for rapid privatisation in Cuba, because it would not be in the economic or political interests of the industrialised countries for the privatisation course to lead to monopoly capitalism. The current tendency of the Cuban government to slow the development of small private businesses and leave important sectors under the control of the state or the military, sometimes in cooperation with multinationals, creates an unsettling basis for privatisation. Cuba must have a great interest in avoiding the mistakes made by Russia in the 1990s, where rapid wholesale privatisation of state monopolies without corresponding institutional safeguards fostered the emergence of monopoly capitalism. That danger could be lessened if Cuba permitted the development of SMEs to ensure a certain degree of competition. The current promotion of cooperatives certainly offers Cuba possibilities to pursue a third way between market capitalism and socialism. But at the same time, strengthening the private sector requires the development of institutions such as competition agencies and a quality infrastructure to ensure that standards are observed. Such institutions must satisfy requirements of transparency, impartiality and legal security if they are to function properly, and that in turn demands a certain degree of autonomy from political decisions. In strengthening its institutions Cuba can draw on the experience of other countries. Here Germany can offer positive and negative experiences gathered during reunification.

The expansion and diversification of exports sought by Cuba will have to build on the existing strengths of the Cuban economy. As the objectives of the guidelines indicate, this is precisely the line pursued by the Cuban government. If, as proposed, exports are to be based more strongly on high-tech and a highly qualified workforce, greater flexibility for initiative will have to be created in this area. Instead, self-employment remains largely restricted to low qualifications. In the sphere of service exports, tourism has succeeded in increasing its contribution to the domestic economy (partly on account of the small numbers of low-yield cruise visitors). On the other hand the deployment of medical personnel abroad generates hard currency and serves political cooperation functions but cannot contribute to value added.

The upcoming dialogue should communicate to Havana that it is in Cuba's interest to make use of all existing possibilities to expand its exports, including the exchange rate. A gradual devaluation of the overvalued Cuban peso is already a stated objective of the guidelines and is currently being implemented (albeit slowly). This will fundamentally make Cuban goods cheaper in the global market and thus contribute to stimulating exports. A devaluation could also lead to a reclassification in the international income statistics. Rather than a political loss of face, this would open possibilities to gain easier access to important markets. Devaluation (or even just a more realistic calculation of GDP) would allow Cuba to rejoin the EU's Generalised System of Preferences for developing countries and to export to the EU on preferential conditions.

The EU's Dialogue and Cooperation Agreement and the joint German-Cuban declaration should be used actively to address human rights questions and the terms for private-sector engagement. These agreements create the basis for the dialogue that will be needed to accompany the developments. Germany and the EU should prepare and embed the exchange by staging regular consultations with stakeholders from business, civil society and academia. This is useful in the external economic sphere because businesses – especially SMEs – face considerable challenges where they seek to engage in Cuba's state-directed market. And the area of human rights in any case demands dialogue with the informed civil society.

Including Cuba in selected areas of the Economic Partnership Agreement between the EU and CARIFORUM would create a good basis for strengthening the EU's cooperation with Cuba, as well as cooperation among the Caribbean countries. Full integration of Cuba in the EPA is currently inconceivable on political, legal and economic grounds. Cuba regards the agreement as a neocolonial and neoliberal instrument that is not helpful for the region's interests. But at the same time Havana fears that the EU's granting of free market access to the EPA partners could function to the detriment of other states – including Cuba.[161] While there is no question of Cuba joining the EPA, it could be interested in other forms of cooperation; for example the EPA contains numerous possibilities for sectoral cooperation between the Caribbean region and the EU including the areas of technical barriers to trade, sanitary and phytosanitary standards, energy and environment, and cultural cooperation. Breathing life into these hitherto largely neglected cooperation formats is already on the agenda anyway; Cuba could be included in some of these via CARIFORUM. Germany (in the context of bilateral activities) and the EU should identify corresponding possibilities in the scope of EPA implementation, in coordination with its Caribbean EPA partners. The implementation of the Cuban-European Dialogue and Cooperation Agreement, which creates the basis for bilateral relations, presents no obstacles to this. The two channels can both be pursued in coherent form.

Germany and the EU could strengthen cooperation in the region by involving Cuba in regional development programmes. Cuba should not be treated as a special case and granted bilateral development funds, when all the other Caribbean countries receive only regional funds from Germany. Concentration on this bilateral relationship cannot be justified by Cuba's political or economic relevance (at best its historical role). Cuba's political role as a valued development donor in the Caribbean region would also speak for trilateral cooperation, in which Germany and Cuba would conduct joint development projects in third countries.

Fundamentally Cuba's perspectives will be better if it is more closely integrated into global trade and investment flows and consolidates its relations with the United States. But in the longer term Havana will need to send clearer and more coherent economic policy messages if it is to realise the potential for development offered by trade and investment. Europe has a great political and entrepreneurial interest in constructively accompanying Cuba along that road.

161 Roberto Smith, "Balance del Convenio de Lomé en el Contexto del Caribe en los Años 90. Algunas Consideraciones sobre el Convenio de Cotonou" [Assessment of the Lomé Convention in the Caribbean contxt in the 1990s: Some thoughts on the Cotonou Agreement], in *Temas de Economía Mundial* (Havanna: Centro de Investigaciones de la Economía Mundial), special issue of *Caribe*, 2004, 47–61 (57).

Abbreviations

ACP	African, Caribbean, Pacific (Group of States)
ACS	Association of Caribbean States
ALADI	Asociación Latinoamericana de Integración (Latin American Integration Association)
ALBA	Bolivarian Alliance for the Peoples of Our America
BNDES	Banco Nacional de Desenvolvimento Econômico e Social (Brazilian Development Bank)
CARICOM	Caribbean Community
CARIFORUM	Forum of the Caribbean Group of African, Caribbean and Pacific States
EEAS	European External Action Service
EIU	The Economist Intelligence Unit
EPA	Economic Partnership Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GSP	Generalised System of Preferences
GTAI	Germany Trade and Invest
HDI	Human Development Index
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
LAIA	Latin American Integration Association
MINCEX	Ministerio del Comercio Exterior y la Inversión Extranjera (Cuban Ministry of Foreign Trade and Foreign Investment)
PCC	Partido Comunista de Cuba (Communist Party of Cuba)
SMEs	small and medium-sized enterprises
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
USSR	Union of Soviet Socialist Republics
WTO	World Trade Organisation