

THAW AND REFORMS CREATE A MIDDLE CLASS AND NEW BALANCE OF POWER IN THE CUBAN ECONOMY

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When in the 60s the Cuban government led by Fidel Castro nationalized all domestic and foreign companies operating on the island and eliminated private ownership of the means of production, there was a radical change in Cuban society. Since then, Cuban society has suffered the consequences of the double embargo that still exists today: the US embargo and the internal embargo that limits the development of productive forces and civil society on the island.

Everything changed, from the social classes to the consumption patterns of the population. The planned economy dismantled the entire existing business structure and the utopia of the centralized socialist economy began, dependent on the former Soviet Union in a first stage and more recently on Venezuela. Never again could Cubans freely buy a house or car. These goods were acquired only by state allocation. Education and health care were provided free of charge for all Cubans. A broad commodity rationing program for basic commodities, still in force, was implemented. Traveling abroad was a privilege for a few, just like staying at a hotel. Wearing ties disappeared from the Cuban public scene, as well as good manners and good morals, which were gradually extinguished as the new political-economic model was imposed.¹ Decades later, social decadence and a

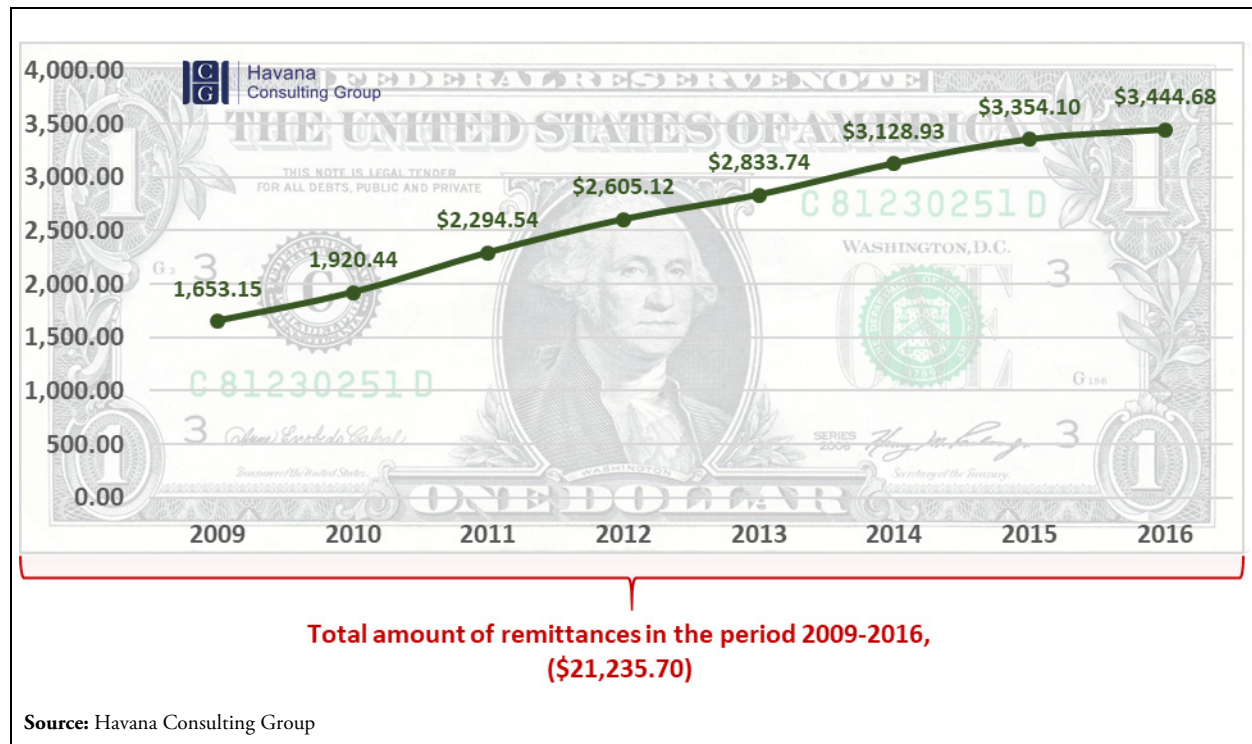
devastated economy were the most visible results of the drastic change begun in 1959. A new DNA transformed Cuban society in the political, the economic and the social spheres.

The economic experiment failed: most state enterprises are bankrupt, the banking system is the most backward in Latin America, there are no credit cards, and ATMs per inhabitant is the lowest in the region. The country in almost six decades, according to the statistics published by the Cuban authorities, has not been able to have a single positive year in its merchandise trade balance. The economy has not been able to generate savings. The gross capital formation to GDP ratio is 7.4%, the lowest in Latin America, which averages over 20%.² The only markets that work with some semblance of efficiency are the dollarized market and tourism, which is managed by large state corporations—mostly in the hands of the armed forces business machine—and joint ventures in association with foreign companies. In this context, the middle class in Cuban society disappeared completely.

Almost 60 years later, a rebirth of the middle class is occurring. With the U.S.-Cuba thaw in relations and a program of domestic economic reforms, a middle class has emerged, created by the development of the

1. Castro Ruz, Raúl. "Orden, Disciplina y Exigencia en la sociedad cubana, premisa imprescindible para consolidar el avance de la actualización del modelo económico." CUBADEBATE. Julio 2013. <http://www.cubadebate.cu/especiales/2013/07/07/raul-castro-orden-disciplina-y-exigencia-en-la-sociedad-cubana-premisa-imprescindible-para-consolidar-el-avance-de-la-actualizacion-del-modelo-economico/#.WRG-P8a1uh8>

2. Pérez-López, Jorge. "El déficit de inversión lastra el crecimiento futuro." THCG BUSINESS REPORT, February 2016, No.1.

Figure 1. Remittances to Cuba (in millions of dollars)

private sector. This middle class has grown rapidly making a strong showing of economic autonomy, great entrepreneurship, strong innovative power and a tremendous force to generate wealth. Undoubtedly, this middle class has boosted the economy of the island in sectors where private work has been allowed, even if only allowed to a limited extent.

FACTORS OF CHANGE

There are two key factors that have marked the emergence of this new middle class: the change of policy towards Cuba implemented by President Barack Obama, which led to the so-called age of the “thaw,” and the domestic policy opening implemented by President Raúl Castro beginning in 2010.

The first factor was the elimination of all U.S. restrictions on remittances and travel by Cuban-Americans to the island. This meant a significant inflow of fresh capital into the country’s economy and greater income for millions of Cubans. These inflows became

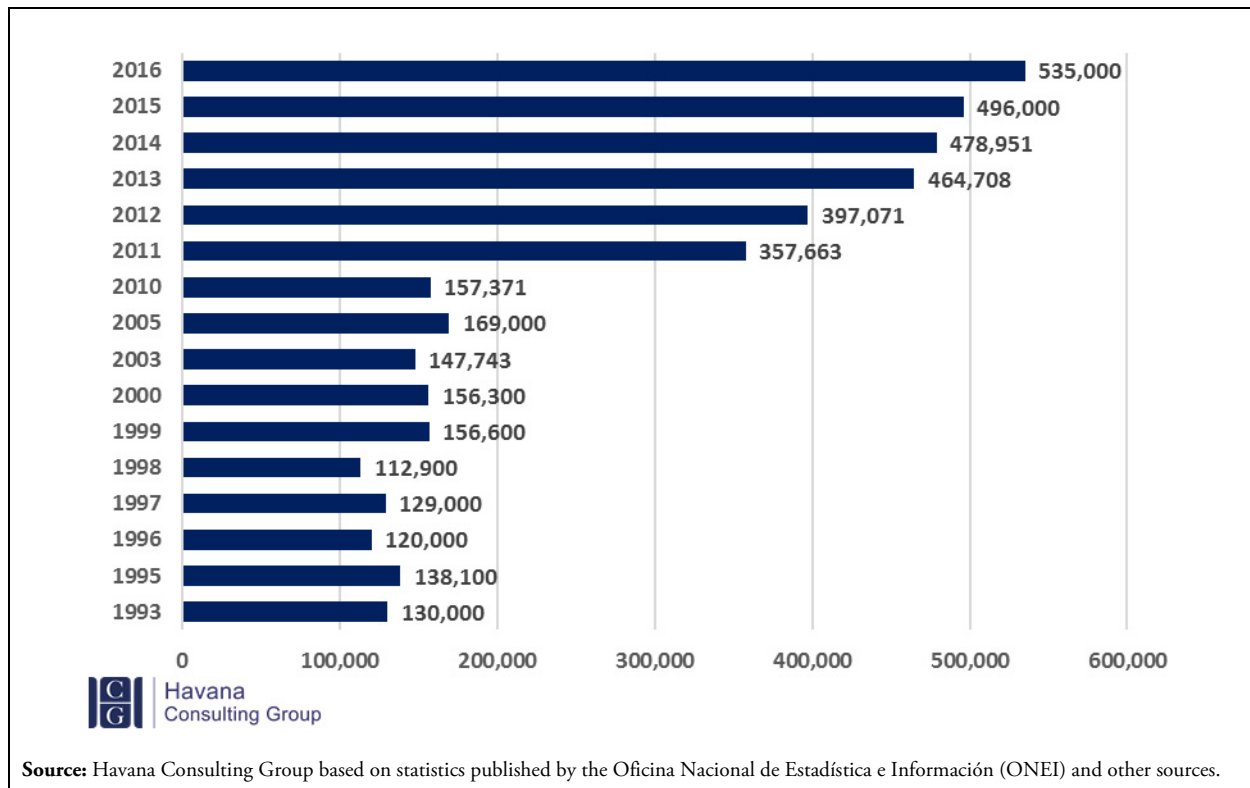
the main source of funds for entrepreneurs to create the businesses allowed by the reforms.

The remittances sent by Cuban exiles since such remittances were decriminalized in 1993, little by little gained a preponderant role in the economy. At present they are the main support of the dollarized retail sector of the island and its total value (in cash and merchandise) exceeds six of the most important exportables of the Cuban economy.³

Since Obama’s arrival to the White House in 2009 until the end of 2016, Cubans have received \$21.2 billion in cash remittances. In that period, remittances grew 108.4%. See Figure 1.

At the same time, the economic reforms launched by Raúl Castro allowed the expansion of the private sector to 201 modalities in an environment of more flexible laws, such as allowing the hiring of staff, expanding the capacity of restaurants, permitting the renting of spaces by businesses, the sale of houses and

3. Morales, Emilio. “Will eliminating “dry foot, wet foot” policy affect remittances to Cuba?”. THCG BUSINESS REPORT, February 2017, No. 1.

Figure 2. Historical series of self-employed workers, 1993–2016

cars, the creation of cooperatives, the possibility of traveling abroad, and the development of a group of activities that were previously not allowed.

The figures show that the opening has allowed hundreds of thousands of Cubans to start a new life. By the end of 2016 it was reported that some 535,000 Cubans worked directly in the private sector through a license issued to them. In 2010 there were 157,371 such license holders, so that in 6 years the number of workers grew 3.4 times. See Figure 2.

In 2016 the activities with the largest number of licenses were: the elaboration and sale of food, with some 59,700 licenses; the transport of cargo and passengers, with 54,350; the rent of houses, rooms and spaces, with 35,066; and telecommunications, with 24,440. Private sector workers, on average, earn a salary at least 10 times higher than the average salary received by state workers.⁴

CUBAN ENTREPRENEURS ARE THE FUNDAMENTAL BASIS OF THE NEW MIDDLE CLASS

As a result of the process of transformation that Cuban society is experiencing in the economic sphere, supported by the two key factors mentioned above, a number of elements associated with consumer behavior and the economic development of the emerging private sector indicate that a middle class has emerged in Cuba. The main elements that lead us to this conclusion are:

1. Creation and consolidation of thousands of successful businesses that have generated a market of hundreds of millions of dollars.
2. Growth in the number of Cubans traveling abroad.
3. Growth in the number of domestic tourists staying in the hotel networks that charge in dollars.
4. Growth of domestic consumption.
5. Creation of informal wholesale market.

4. Mesa-Lago, Carmelo. "Self-employed workers: force for change?". THCG BUSINESS REPORT, October 2016, No. 5.

Figure 3. Collage of some brands created by Cuban entrepreneurs in various sectors of the economy



Source: Havana Consulting Group, from an internet search.

In the period 2010–2016 there has been a boom in the Cuban private sector. Entrepreneurs have developed very successful and profitable business models. Taking into consideration the number of licenses that are active and the volume of business they generate, the most significant businesses are: privately-owned restaurants, popularly called “paladares”; hostels for renting rooms; beauty salons; cellphone repair shops; sale of footwear; transportation; and wholesale trade activities. The latter is an activity that has been developed despite its not being approved by the government. The above-mentioned modalities generate a volume of business that can be estimated at between 2.5 and 3.8 billion CUC annually. See Figure 3.

The entrepreneurs working in the mentioned modalities and the rest of the modalities authorized to carry out self-employment have formed a very successful business network. Many of these businesses have even created their own brand.⁵ See Table 1.

ENTREPRENEURS A NEW FORCE IN THE BALANCE OF POWER OF THE CUBAN ECONOMY

The results achieved by Cuban entrepreneurs in such a short time, despite the limitations they face—high taxes, lack of a wholesale market to acquire inputs, among other difficulties), have generated a new map in the balance of power in the Cuban economy. Currently this movement of entrepreneurs generates 17.8% of the gross income of the economy and has become a necessary and essential force in the development of the country.

In almost 60 years of socialist economy, the non-state sector had never reached so much importance within the economy of the island. Currently, the armed forces (Grupo GAESA and MININT) control certain strategic sectors, such as 85% of the retail market, 40% of the hotel sector within the Cuban tourist industry, the Mariel Special Development Zone, 27% of the telecommunications company ETECSA,

5. THCG Business Intelligence Unit, “Brands in Cuba and the enigma of advertising: great changes are coming”. THCG BUSINESS REPORT, April 2017, No. 2.

Table 1. Estimated revenue generated by the private sector in the 7 most profitable modalities, 2016

Modalities	Licenses	Annual Minimum Revenue Estimated (CUC)	Annual Maximum Revenue Estimated (CUC)
Restaurants (paladares)	1,712	369,792,000	6,933,600,000
Beauty salons ^a	17,837	120,185,556	287,222,172
Wholesale market	—	1,500,000,000	2,000,000,000
Lodging ^b	35,066	123,712,848	262,889,802
Shoe production	7,902	154,094,400	222,580,800
Telecommunications	24,440	96,782,400	129,043,200
Transport	54,350	215,226,000	286,968,000
Total	141,307	2,579,793,204	3,882,063,974

a. Refers to the licenses of different modalities associated with beauty salon activities: masseuses, hairdressers, barbers, manicurists, sports instructors, and make-up artists.

b. Refers to the total of licenses for the rent of houses and rooms, both in CUC and in CUP.

among others. However, its business structure only represents 21% of the gross income of the Cuban economy, not 60%, as the media and news agencies have stated in recent reporting. The rest of the state apparatus controls 61%: exports of sugar, nickel, petroleum products, medical services, rum, tobacco, seafood, biotechnology, telecommunications, and so on. See Figure 4.

The 535,000 people who currently work in the private sector officially, plus another half a million who do so informally, receive an average minimum remuneration 10 times higher than that of a state worker. This significant difference in wages has given rise to the creation of new market segments with different levels of purchasing power, with consumption patterns different from the rest of the population.

Two aspects of consumption statistics show the emergence of these new segments the market, which undoubtedly represents the birth of a middle class on the island: the growth of national tourism in hotel networks that charge in dollars and travel by Cubans abroad.

NATIONAL TOURISM HAS GROWN TREMENDOUSLY

National tourism has had meteoric growth in the last years. In 2016, more than 991,122 Cubans stayed in hotels on the island,⁶ establishing a record in the

country's tourist history. This figure is even more remarkable if we take into account the rise in prices of tourist services brought about by the avalanche of North American tourists, with lodging prices per room rising by more than 95% on average with respect to the previous year.⁷

This rapid growth took the Cuban tourist industry by surprise. Today the number of national tourists is slightly lower than from the largest international tourist emitter to the island, Canada, which closed the year 2016 with 1,198,917 tourists.

To get an idea of the impact, let's look at the statistics. In 2008, the number of national tourists that stayed in the hotel chains that operate in dollars was 61,508. However, when in 2009 President Barack Obama removed some restrictions on remittances and travel to Cuba, the effect was immediate: the number of Cubans staying in hotels destined for international tourism grew year after year. In 2016, the number of national tourists was 991,122, a huge growth of 1,511.4%. See Figure 5.

As mentioned earlier, two factors have impacted this growth: the increase in Cuban-American travel to the island and the growth of the private sector. The increase in Cuban-American travel has allowed many Cubans on the island to enjoy stays in the hotels as guests of their relatives who live in the USA and trav-

6. Perrelló Cabrera, José Luis. "Indicadores básicos del Turismo nacional pagado en CUC." Marzo 2017.

7. THCG Business Intelligence Unit. "The thaw strongly impacts the prices of the Cuban tourism market". THCG BUSINESS REPORT, April 2017, No. 2.

Figure 4. Balance of power in the current Cuban economy, private sector vs. state, 2016

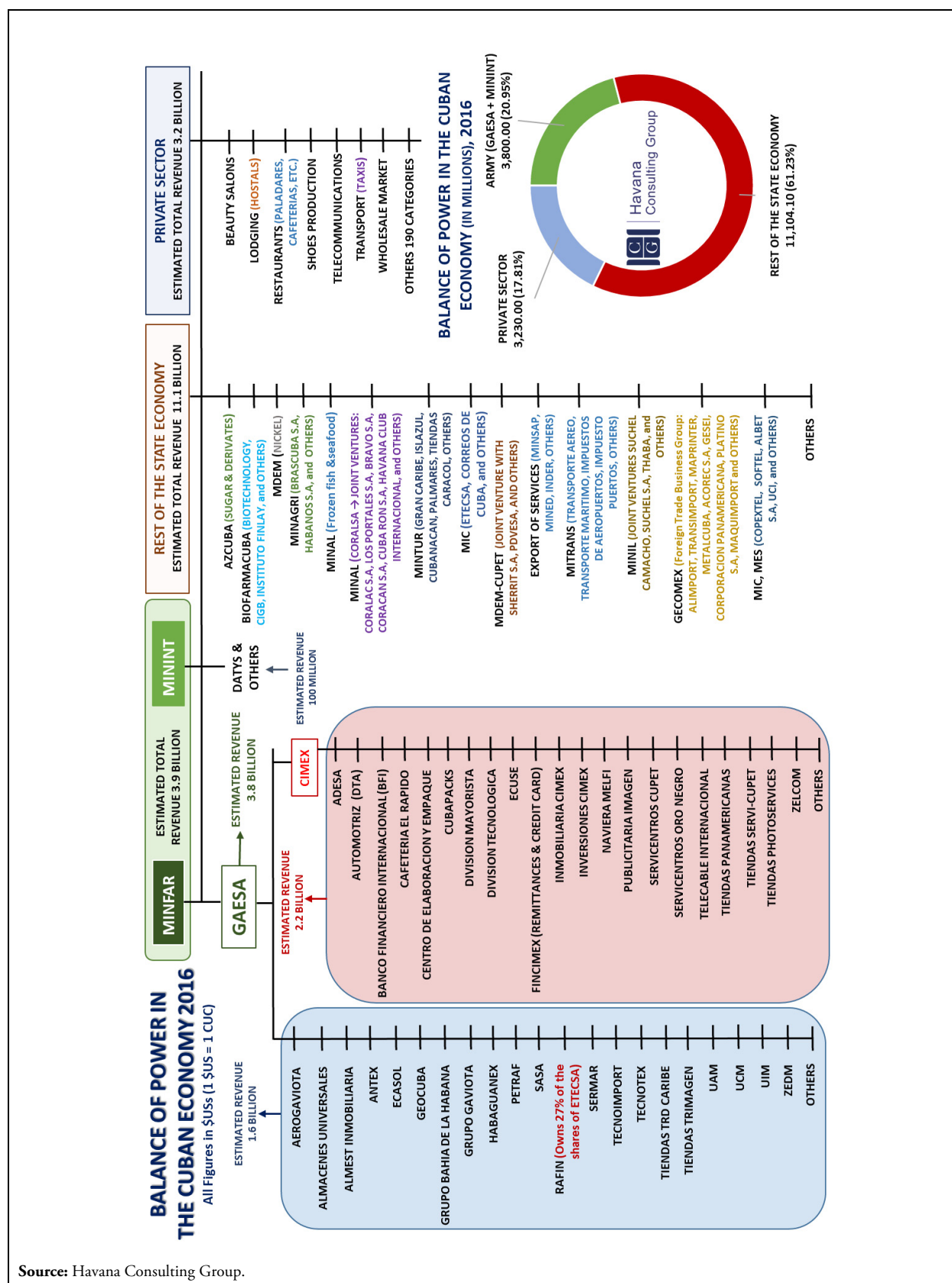
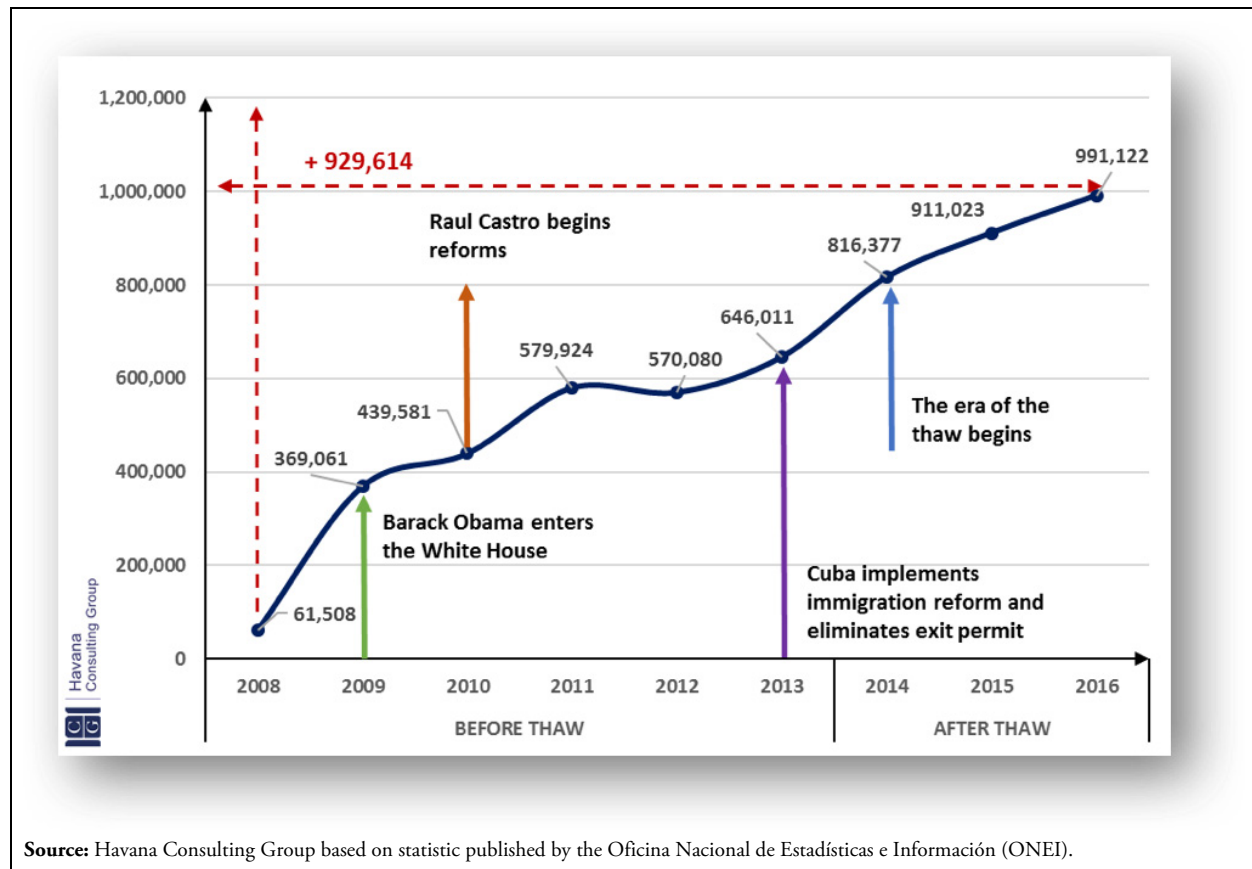


Figure 5. National tourists hosted in hotels, 2010–2016

el to the island. A study by HCG in 2014 found that 37% of Cuban-Americans who traveled to the island invited their relatives staying on the island to stay at hotels for at least a weekend, mainly at Varadero, the keys to the north of Villa Clara, and in Guardalavaca, Holguín.⁸ This share has been increasing. Currently it is estimated that about 45% of Cuban-Americans who travel to the island invite their relatives on the island to stay in a hotel for two or three days.

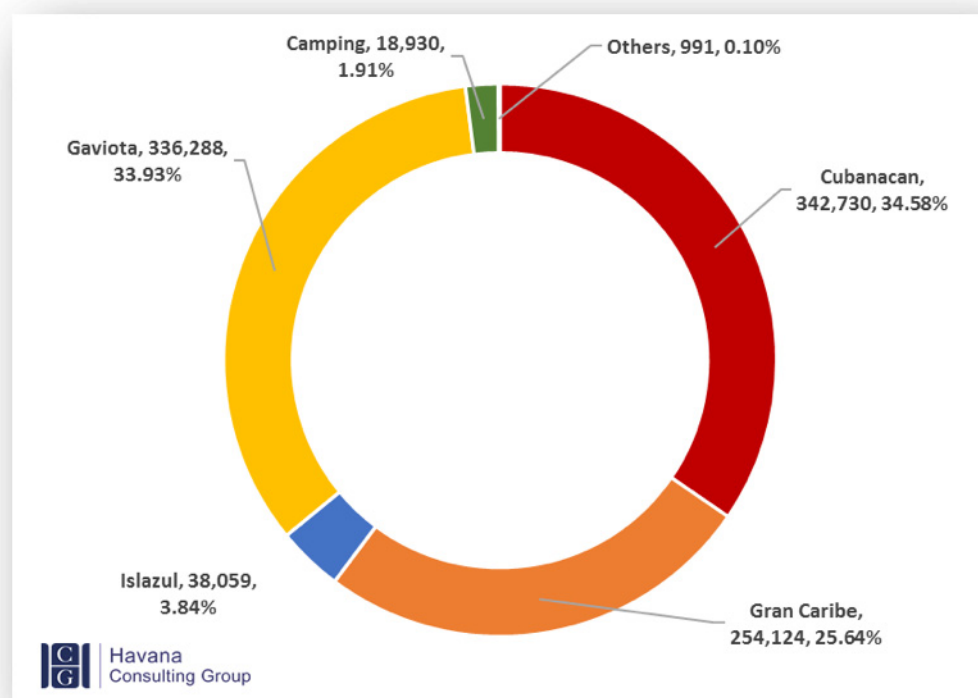
The growth of the private sector has also increased the purchasing power of hundreds of thousands of Cubans, allowing them to vacation in tourism hotels. In 2016 almost 1 million Cubans stayed in the four hotel chains operating in Cuba; 94.15% of them stayed in the chains that manage the highest-priced hotels: Cubanacán (34.58%); Gaviota (33.93%); and Gran Caribe (22.64%). See Figure 6.

In 2016, a study carried out by HCG that monitored prices of a sample of 209 hotels operated by the Cubanacán, Islazul, Gran Caribe and Gaviota chains, found that the average price per room per night ranged from 91.35 to 226.00 CUC. See Table 2.

Analyzing prices by hotel category for each hotel chain, the Cubanacán chain had the highest prices in category 2* hotels, with an average annual price of 96.81 CUC per night. In category 3*, 4* and 5*, the highest average prices were for the Gaviota chain, with 148.55, 198.82 and 257.53 CUC, respectively. See Table 3.

The very high 2016 prices across the different chains gives us an idea of how much the purchasing power of this new middle class has grown in recent years.

8. Morales, Emilio. "Informe anual sobre remesas a Cuba." 2014.

Figure 6. Number of national tourists who stayed in hotel chains, 2016

Source: Havana Consulting Group based on statistic published by the Oficina Nacional de Estadísticas e Información (ONEI).

Table 2. Average annual price per room per night in Cuba hotels chains, 2016

Hotel Chains	Hotels	Annual Average Price
Cubanacan	50	\$105.82
Islazul	37	\$91.35
Gran Caribe	24	\$155.04
Gaviota	98	\$226.09

Source: Havana Consulting Group.

Note: It includes hotels in the chains Sol Meliá, Iberostar, Accor, NH Hoteles, Be Live Hotels, etc.

TRAVEL ABROAD

But the growth of national tourism has transcended national boundaries. Today thousands of Cubans travel abroad for migratory reasons or to engage in business or pleasure. This is due to the implementation in 2013 of a new immigration policy, which

Table 3. Average annual price per room/night by hotel category in Cuba hotel chains, 2016 (in CUC)

Chain/Hotel Category	2*	3*	4*	5*
Cubanacan	96.81	102.78	124.00	132.00
Islazul	59.11	127.53	89.00	–
Gran Caribe	62.00	123.09	175.45	375.00
Gaviota	61.50	148.55	198.82	257.53

Source: Havana Consulting Group.

eliminated the exit permit requirements and allowed Cubans to travel abroad more easily.

According to statistics published by the Cuban authorities, from January 2013 to December 2016, some 671,000 Cubans traveled outside the island. The number of trips made by Cuban residents abroad during that period was 1,745,000 trips⁹,

9. EFE. Más de 600.000 cubanos viajaron al exterior tras eliminarse el permiso de salida". Enero 2017. <http://www.efc.com/efc/america/portada/mas-de-600-000-cubanos-viajaron-al-exterior-tras-eliminarse-el-permiso-salida/20000064-3148884>

which means that some of these travelers do it frequently.

The countries most visited by Cuban travelers have been the US, Panama, Mexico, Ecuador, Spain, and the Dominican Republic. These trips have represented an estimated expenditure of 1,047 million dollars for the purchase of airline tickets alone, at the rate of about 600 dollars per ticket (recall that until the end of 2016, air tickets to the US cost between 450 and 500 dollars on average), an impressive figure that denotes the significant purchasing power of this segment of the Cuban population.

The reason for these trips abroad is diverse. It is estimated that in the period 2013–2016, around 130,000 Cubans traveled for migratory reasons, while the remaining 541,000 did so for work, tourism and business reasons.

The most visited destination has been the EE.UU. During the two mandates of President Obama (2009–2016), 188,115 visas were granted to Cuban citizens,¹⁰ in addition to the 20,000 migrant visas and thousands of additional migrant visas granted each year. See Table 4.

Table 4. Tourist visas granted by the U.S. to Cubans, 2009–2016

Year	Number of Tourist Visas
2009	17,690
2010	20,768
2011	16,654
2012	20,200
2013	36,787
2014	41,001
2015	22,797
2016	12,218
Total	188,115

Source: U.S. Department of State.

A considerable share of these visas are valid for five years, which explains why Cubans make several trips,

sometimes multiple trips in the same year, in some cases for business reasons to buy merchandise and then sell it in the informal market. Others spend two to three months at a time abroad, working informally and returning to the island with the money saved. Another group travels for family tourism and vacations for example to Orlando tourism parks or to other cities in the country.

Studies conducted by HCG have revealed that some 30,000 Cubans with Spanish nationality travel to the US every year a couple of times a year for periods of 87 days. Most of them work temporarily in various jobs, with the most common being in agriculture, factories and patient care.

In 2016 more than 100,000 Cubans traveled to Mexico by air. Cubans have become the fastest growing tourist segment from Latin America, with a growth of 58.4% with respect to the previous year.¹¹ Since the implementation of the new immigration reform in 2013, 220,715 Cubans have traveled to Mexico. See Figure 7.

Another group of Cubans, estimated at about 20,000, make trips to Panama with a frequency of twice a month on average. These trips are strictly business-related, and are intended to purchase merchandise at the Colón Free Trade Zone to acquire goods to supply retailers in the island and to sell various products in the informal market.¹²

In addition, there is another group that travels to engage in tourism. The main destinations of this group are: USA, Cancún, Dominican Republic, and Europe.

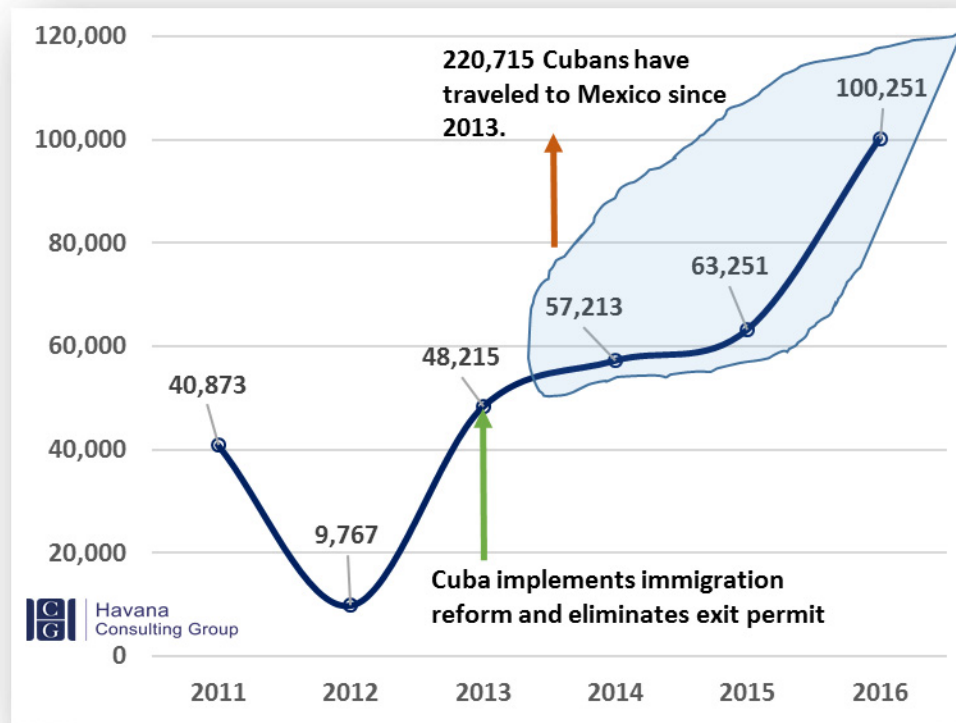
CONCLUSIONS

In Cuba, a middle class with considerable purchasing power has been born as a direct consequence of the change of policy towards Cuba implemented by Pres-

10. Cancio, Wilfredo. "EEUU recorta visas para visitas de cubanos." Telemundo, Marzo, 2017. <http://www.telemundo51.com/noticias/cuba/EEUU-recorta-visas-para-visitas-de-cubanos-415141093.html>

11. Martínez, Everardo. "México vive 'boom' de turistas cubanos." EL FINANCIERO. Febrero, 2017. <http://www.elfinanciero.com.mx/empresas/mexico-vive-boom-de-turistas-cubanos.html>

12. THCG Business Intelligence Unit. "Cuban entrepreneurs create long-distance wholesale market". THCG BUSINESS REPORT, February 2017, No. 1.

Figure 7. Historical series of Cuban tourists visiting Mexico, 2011–2016

Source: HCG based on data published by the Mexican newspaper El Financiero.

ident Obama and the economic reforms undertaken by President Raúl Castro.

An important segment of the population has achieved economic independence from the state and has managed to create a successful business network that brings together thousands of private businesses. More than half a million Cubans officially work in the private sector, while another half a million do so informally.

The financial support of Cuban exiles has been a key factor in the development of Cuba's nascent private sector, which has managed to create a market for goods and services that is estimated at between 2.5 and 3.8 billion dollars. The purchasing power of this segment of the population is at least 10 times higher than that of workers in the state sector.

This emerging middle class has become the second tourist segment in the island in number of vacationers, only surpassed by Canada. In 2016 it con-

sisted of about 991,122 national tourists who were hosted in the hotel chains that provide their services in dollars.

The creation of this middle class has brought wealth and prosperity to thousands of Cuban families, who have increased their purchasing power, allowing them to travel within Cuba and abroad for tourism and business travel.

This change that is taking shape in Cuban society is irrefutable proof that, if the government were to decide to make a real economic opening and release the country's productive forces, with a reform like Viet Nam's or China's, in two to three years Cuba could take out millions of Cubans out of poverty. In a short time Cuba would be another country.

This result also shows that the economy of the country urgently needs new rules that will allow free enterprise to take advantage of the entrepreneurial capacity that Cubans have shown. The diaspora can

play an important role in the country's economic recovery if the right legal framework were created. If China and Viet Nam were able to take more than 350 million people out of poverty in less than 25 years, why couldn't Cuba pull out 10 million in less than five years? Undoubtedly, the conditions are present to do so.

Cuba needs a change in social, economic and political DNA, which of course is going to take a long time to occur. Eliminating the current DNA that has

lasted nearly 60 years in Cuban society is going to be a complex process that will undoubtedly accelerate as the generation in power physically disappears. At least the mutation to a new DNA has already begun: the old DNA resists, but each time it is losing more and more force. The fact that Cuban entrepreneurs already control 18% of the gross income of the economy despite the limitations they face is a good sign that the mutations have begun.