

April 30, 2018

## **Generational Change in Cuba?**

*(N.B. Due to business travel, the next report will be published May 14.)*

On April 18, the Cuban National Assembly elected Miguel Díaz-Canel as the new president of Cuba. On the following day, he was sworn into office. There has been much media conversation about a generational shift in Cuba. In this report, we will discuss the potential for change on the island nation, which has been communist since the 1959 Cuban Revolution.

We will begin this analysis with a refresher on communist government structure. A short biographical sketch of the new president will follow, which will include a list of previous heirs apparents who were, for various reasons, deemed unworthy. Next, we will examine why Miguel Díaz-Canel emerged as the winner and what it portends for Cuban foreign and economic policy. Finally, we will conclude with potential market ramifications.

### **Typical Communist Government Structure**

Marx envisioned that communism would lead to a “withering away” of the state as the proletariat would take control of the means of production across the world and thus the need for government would cease.

However, Marx never detailed how this process would actually occur. Because this endpoint was undefined, as communist nations emerged, the revolutionaries who overthrew existing governments were forced to form replacement administrations. They

generally settled on a parallel structure of government and party. Communist states usually only have one accepted party so the separation of party and state was mostly fiction. However, it was common to see the head of the government usually called the premier (as in the Soviet Union) or president (as in Cuba and China). In China, for example, the general secretary of the Communist Party of China and the office of the president are held by the same person. Recently, Chairman Xi was able to end term limits on the office of the president, allowing him to maintain that position past 2023.<sup>1</sup> Although the office of president in a communist state is generally ceremonial, in China, it was important enough for Chairman Xi to insist on keeping the position past two terms.

The elevation of Miguel Díaz-Canel to president isn't significant in terms of Cuba's power structure. Raúl Castro remains head of the Communist Party of Cuba and therefore holds the reins of power.<sup>2</sup> However, it is possible that the new president could become the leader of Cuba's communist party when Castro, who is 86 years old, steps down. Then again, there is no guarantee this will occur. Osvaldo Dorticós Torrado was president of Cuba from 1959 to 1976 when he was replaced by Fidel Castro, who unified the government and the party under himself. As Fidel's health deteriorated, he was succeeded in 2008 by his brother, Raúl, who held three

<sup>1</sup> See WGRs, Emperor Xi: [Part I](#) (3/5/2018) and [Part II](#) (3/12/2018).

<sup>2</sup> It should be noted that Castro will continue to be head of the armed forces as well, a position he has held since the 1959 revolution.

positions of power—the presidency, leader of the Communist Party of Cuba and commander in chief of the military, the latter being a role he assumed after the revolution. As this history shows, the return to separating the presidency from the leadership of the communist party would not be unprecedented.

### **Who is Miguel Díaz-Canel?**

In Cuba's power structure, Miguel Díaz-Canel, at 58 years old, is rather young. He spent years as a government and party functionary, known mostly as a manager and not a visionary. During his military service, he was part of Castro's security detail. He was the Communist Party of Cuba's liaison to Nicaragua and has had close contact with the Castro family since the 1980s.

For the most part, he would be considered a “grinder.” He has performed in his positions competently but not spectacularly. There is nothing to suggest he has an independent power base. As for his aspirations, he wants to expand telecommunications and the internet across the island and improve the cultural lives of Cubans. However, he appears to view the economy in a manner consistent with the Castros.

There have been two patterns of communist economic development since the fall of the Soviet Union. The first model was developed by China. The Communist Party of China (CPC), guided by Deng Xiaoping, allowed for markets to direct most economic activity while the party maintained strict control of the political system. Although the West expected China to eventually evolve into a multiparty democracy (following a similar path of authoritarian regimes in other parts of Asia), in fact, there is little evidence that the CPC has any intention of easing its political control of China. Despite consistent government intervention in the

economy, the Chinese government does allow markets to manage most of the distribution of goods and services. China's economic development has been remarkable, although income inequality has risen dramatically.<sup>3</sup> Vietnam has also followed this model. Russia attempted to follow this model but the breakdown in government after the collapse of the Soviet Union led to a breakdown of order that fostered a dysfunctional economy that hampered the development of a market system. For the most part, the Russian economy is heavily dependent on natural resource exports and has failed to develop many other industries.

The other model has been followed by Cuba and North Korea. In this model, the communist party maintains control of both the political system and the economy. The economic systems of Cuba and North Korea were supported by the Soviet Union, and their economies were adversely affected after its collapse in 1990. In response, both Kim Jong-il and Raúl Castro implemented limited market reforms which boosted economic growth. However, once the economy partially recovered, the “experiment” with markets was ended.<sup>4</sup>

### **Lessons of Earlier Heir Apparents**

There have been four other “rising stars” since the mid-1980s that were thought to have the inside track to eventually replace the Castros. They were:

*Carlos Aldana* (b. 1952) was the third most powerful person in Cuba, holding the

<sup>3</sup> <https://www.ft.com/content/3c521faa-baa6-11e5-a7cc-280dfe875e28> (paywall)

<sup>4</sup> The current leader of North Korea, Kim Jong-un, seems to be less concerned about market distribution. It is possible that North Korea may move to the Chinese model of communist development.

position of director of the Ideological Department when he was ousted by Raúl Castro in 1992. Officially, his crime was personal extravagance but, in reality, he supported the policies of Mikhail Gorbachev, who wanted to open the Soviet system. The subsequent collapse of the Soviet Union discredited Gorbachev and the policies he espoused. At the time, the Castros were “circling the wagons” as they faced the end of subsidies from the Soviet Union and did not want any sort of internal dissent among the ruling elite. And, perhaps most importantly, Aldana was seen as occasionally supporting reforms which might have enhanced his personal popularity, which the Castros saw as a threat and thus intolerable.

*Roberto Robaina* (b. 1956) was foreign minister from 1993 to 1999. At the time of his appointment to the Political Bureau of the Cuban Politburo, he was its youngest member. In 1999, he was accused of corruption, taking bribes from foreign businessmen and having unauthorized conversations with diplomats. He was stripped of his party roles and became a private citizen.<sup>5</sup>

*Felipe Pérez Roque* (b. 1965) was foreign minister from 1999 to 2009. At the time of his appointment, he was the youngest member of the Cuban cabinet and the first born after the 1959 Cuban Revolution. He succeeded Robaina. Pérez Roque is credited with deepening trade relations with China.

---

<sup>5</sup> When Raúl Castro denounced him at a party meeting in 1999, Castro said, “I’m not going to let people like you f\*ck this revolution three months after the oldest ones disappear.” This comment suggests the Castros are concerned about the revolution and their legacy when their generation passes on.

[https://elpais.com/diario/2002/08/02/internacional/1028239212\\_850215.html](https://elpais.com/diario/2002/08/02/internacional/1028239212_850215.html)

However, he was allegedly recorded making disparaging remarks about Fidel Castro and other senior party leaders. In 2009, he was deposed from all party positions.

*Carlos Lage Dávila* (b. 1951) was an advisor to Fidel Castro and considered Castro’s “economic fixer.” He was a vice president, a member of the Politburo and considered the “prime minister” of Cuba. During the “special period” after the fall of the Soviet Union, Lage initiated a series of economic reforms designed to loosen regulations on the formation of markets and boost domestic growth. He was also credited with negotiating subsidized oil from Venezuela, which was a key support for the Cuban economy. Considered close to Fidel, when the leader of the Cuban Revolution announced his retirement there was some speculation that he could be appointed to lead Cuba if the party leadership did not want to pass power to the elderly Raúl Castro. However, when the party decided to install Fidel’s younger brother, it appears that Raúl saw Lage and Pérez Roque as threats. Like Pérez Roque, Lage was stripped of his party affiliation.

As Raúl Castro was ousting Lage and Pérez Roque, he appointed Díaz-Canel to the position of first vice president, signaling that he was next in line to run the Cuban government. However, as the list of “fallen angels” above shows, one can fall from favor quickly in the Castro regime.

Nevertheless, there is a likely chance that Díaz-Canel survives. First, he has seen the downfall of others and knows that becoming too popular or threatening the “old guard” is a surefire way to fall from grace. Second, there is nothing in his background to suggest he is a reformer. He shows all the signs of being a cautious leader who won’t make any aggressive moves to change Cuba’s

economic and political system. Third, Raúl Castro has learned, too. Promoting then deposing various potential successors carries its own costs. Only megalomaniacs, such as Stalin, seem to enjoy toying with and destroying people's lives. All four of the early heir apparents were well thought of by the Castros but they all showed signs of personal ambition that could have threatened the Castros' continued rule over Cuba. Thus, Díaz-Canel was likely selected because he seems to lack significant personal ambition. Much like Hugo Chavez when he chose Nicolás Maduro as his replacement, he wanted someone dependent upon him for power that way he would not be a threat. Unfortunately for Venezuela, Chavez severely mismanaged the economy and it will take a strong leader to remedy the situation; Maduro isn't that leader. Finally, Raúl Castro is essentially using the presidency of Díaz-Canel as something of a "test drive." Castro continues to hold the levers of power so he can observe his behavior and, if it appears threatening, he can make Díaz-Canel another fallen figure.

However, the problem for Castro is that he isn't immortal. In fact, the leaders of the Cuban Revolution generation are rapidly aging out. If Castro isn't careful, he will appoint a leader that isn't a threat to him but is incapable of managing the country after the revolutionary generation passes on. Simply put, Castro may be setting up Cuba for the Maduro problem.

An authoritarian leader with failing health carries great risks. His natural instinct is to select a number two that is no threat to his continued rule. And, given the huge egos usually involved, it is an atypical authoritarian who doesn't believe he is immortal. Thus, the temptation to pick a weak replacement is great. However, as the Venezuelan example shows, an inadequate

successor can be a disaster. Cuba could soon become the last Stalinist regime on earth. To quote one of our favorite movies, "It's a bold strategy...let's see if it pays off for them."<sup>6</sup>

### **Ramifications**

Cuba is important to the U.S. because if a foreign power controls the island it could conceivably interdict U.S. shipping from the Port of New Orleans.<sup>7</sup> Russia and China have made significant inroads into Cuba. Both have forgiven large debts (Russia \$32.0 bn and China \$6.0 bn), and China is now Cuba's largest trading partner. Currently, neither the Chinese nor the Russian navy is big enough to use Cuba as a base of operations to disrupt U.S. shipping. At the same time, a working relationship between Cuba and the U.S. would prevent any outside power from threatening to use the island's proximity against the U.S.

Unfortunately, better relations are unlikely in the near term. President Obama relaxed some elements of the economic embargo and travel restrictions, but President Trump has reversed many of those changes. In addition, American diplomats in Havana were harmed by some unknown "noise" weapon<sup>8</sup> which has further soured relations. Since we don't expect the new president to take steps to improve the situation between the U.S. and Cuba, there is no reason to believe a thaw is likely anytime soon.

If the U.S. were able to improve relations with Cuba it would be a boon to the tourism industry as a very desirable island, which could be developed for that purpose.

<sup>6</sup> <https://www.youtube.com/watch?v=9HVeJEB5uVk>

<sup>7</sup> For background on Cuba and American geopolitics, see WGR, [The Cuban Thaw](#), 1/5/2015.

<sup>8</sup> <https://www.usatoday.com/story/news/world/2018/02/15/health-problems-u-s-diplomats-cuba-still-mystery/340471002/>

Although we don't expect that opportunity to develop in the near term, if relations improve, an opportunity for investors could develop.

Bill O'Grady  
April 30, 2018

*This report was prepared by Bill O'Grady of Confluence Investment Management LLC and reflects the current opinion of the author. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.*

### **Confluence Investment Management LLC**

Confluence Investment Management LLC is an independent Registered Investment Advisor located in St. Louis, Missouri. The firm provides professional portfolio management and advisory services to institutional and individual clients. Confluence's investment philosophy is based upon independent, fundamental research that integrates the firm's evaluation of market cycles, macroeconomics and geopolitical analysis with a value-driven, fundamental company-specific approach. The firm's portfolio management philosophy begins by assessing risk, and follows through by positioning client portfolios to achieve stated income and growth objectives. The Confluence team is comprised of experienced investment professionals who are dedicated to an exceptional level of client service and communication.