

MEASURES NOT TAKEN: ISSUES FOR TODAY AND TOMORROW

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Several months ago I was writing a paper on the Cuban economy and mentioned that fortunately for the transition, the Cuban economy was relatively simple. I acknowledged the measures the Cuban Government had already taken and noted that much more needed to be accomplished. But I thought that further reform could be fairly straight forward were the Cuban Government to decide to take the necessary measures. As I continued writing, I soon discovered my mistake. Whatever simplicity might exist in the Cuban economy, its socialist overlay had made it much more complex than I had realized. It became apparent how incomplete and fragile were the laudable steps already taken. Without further action the initial reforms could be largely undone in a period of chaotic transition. This paper therefore accepts the good work already done and focuses on “Measures Not Taken.”

I take as a given that untangling the Cuban economy from the web of policies of centralized planning and socialism should have certain key interdependent objectives. These include a stable government able to make and execute policies that have broad based public support, economic recovery, a high level of employment, the preservation of a social safety net

and a minimum of corruption. At the moment the Government of Cuba, is not adequately addressing any of these issues.

CUBA HAS NOT TAKEN MEASURES TO DEAL WITH EMPLOYMENT

One vital statistic explains much of what is happening in Cuba today. The Cuban Government reported only 7.6 percent unemployment in 1996, but 55 percent of the employment age population (age 20 years and above) was not formally employed.² A comparative figure for the United States is 30 percent.

So where are the missing Cubans? They are still there. They are simply not interested in government wages that average eleven dollars a month. The highest wage—for senior doctors and other professionals—was until recently 22 dollars/month. These are not living wages. These are not living wages even taking into account the ration cards, the free medical care and low housing costs.

Absent remittances from abroad, under-the-table payments from joint ventures and tips from tourism, families need to supplement their income. One alternative is to become legally self-employed, an opportunity that has been part of the government’s reform program. Unfortunately, like many of the Cuban

1. The contents of this paper are the sole responsibility of the author and do not necessarily represent the views of the United States Government or the Department of State.

2. Calculated from *Anuario Estadístico 1996* on the basis of population ages 20 years and above. The 45 percent of the employment age population that was in the formal labor sector was distributed as follows: state organizations, 36 percent; cooperatives, 4 percent; private associations, 2 percent; self-employed, 2 percent; mixed enterprises, 1 percent; and political organizations, 0.5 percent.

Government reforms, there has been an ambiguousness in government policy. Very high tax rates on *cuentapropistas* and restrictions on the scope of their activities have diminished the attractiveness of this source of employment. The situation is not helped by continuous government rhetoric linking the *cuentapropistas* to illegal activity. Reaching a high of 208,000 employed in December 1996, the number has dropped steadily to a current 130,000.³

Faced with being honest, but hungry, or becoming a criminal and feeding one's family, the great majority of Cuban citizens—and I stress the great majority—have decided to ignore the law. Many have opted out of the formal labor market to become unlicensed carpenters, plumbers, automobile mechanics, taxi drivers, prostitutes, or small scale retailers whose wares are often goods stolen from government corporations and sold from the back of bicycles. Others use their illegal services or buy their products. The current regime constantly complains of external conspiracies. Its greatest problem however comes from within, as virtually the entire population conspires to meet their basic economic needs. “Hay que resolver” may have long been Cuba's favorite phrase, but in recent years it has taken on a new urgency.

Unfortunately, as the psychological barriers to law-breaking have fallen, other crimes, muggings, breaking and entering, and armed robbery have increased. The general breakdown of civil society that characterizes much of the former Soviet Union today may unfortunately be a harbinger for tomorrow's Cuba.

The current Cuban Government's solution to this problem is, to say the least, unfortunate. It has created considerable hardship and driven illegal economic activity further underground, but until the Cuban Government allows the market to set prices the black market will continue.

SOLUTIONS

So what should the Cuban Government do? My suggestions are neither novel nor new. They came originally from the Cuban Government itself.

First, they should take their own policies seriously. The Cuban Government should reduce the tax level and end the seeming arbitrariness of the tax administration and various government inspectors. Note that I am not suggesting they lift taxes or ignore reasonable regulations on sanitation or other appropriate laws. Even a free market economy requires revenue for the government, but the current system is seen as both unfair and confiscatory. The Government needs to send a clear signal to its cadres that *cuentapropistas* are important to the economy and that their job is to help private business obey reasonable laws, not close them down.

Simultaneously they need to legalize small and medium size businesses. This was discussed extensively in the Cuban media in the mid-1990s. They need to give these businesses the right to produce a wide range of goods and services and to hire non-family members as employees. Given legitimacy and encouragement these businesses could lead the way to increased legal employment, a larger tax base, a greater respect for the law, and economic recovery.

ECONOMIC RECOVERY: TOURISM IS NOT ENOUGH

Cuba has not the necessary measures for sustained economic recovery. In a huge bet, it has placed almost all its hopes on tourism. At the December 1998 meeting of the National Assembly, vice-president of the Council of State Carlos Lage reported that 500 million dollars—mostly Cuban money—had been invested in tourism in 1998.⁴ In March 1999, Lage lowered that amount to 430 million dollars.⁵ Both figures suggest that almost all the government's net earnings from tourism and almost one third of total

3. *Economics Press Service*, Año 11, No. 12 (June 30, 1998) and “Realizan balance del Trabajo,” *Trabajadores* (February 15, 1999).

4. “Los resultados de 1998 son positivos y confirman la tendencia a la recuperación económica,” *Granma* (December 23, 1998).

5. “Income increases for 10th consecutive year,” *Granma Internacional* (March 1999).

gross investment is being reinvested in the same sector.⁶

In some ways this bet has paid off. Tourist visitors and gross income both more than doubled between 1994 and 1998 and have apparently increased significantly again in the first half of 1999. Hotel operators in Cuba see continued growth for several years to come, although reportedly slim profit margins may eventually discourage some foreign investment.

Tourism, however, cannot be the country's sole engine of growth. Although second only to remittances in terms of net foreign exchange earnings, it contributed on a net basis only three percent of Cuba's peso-denominated GDP in 1997.⁷ The industry has also been very slow in developing linkages to the rest of the economy. Most inputs still have to be imported and the collateral services and stores that bring in much of the revenue in tourism elsewhere have not been developed. At the end of 1998, tourism employed 81,000 persons.⁸ Note that is just a little more than the 78,000 lost jobs among the *cuentapropistas* in the last three years.⁹

ECONOMIC RECOVERY AND ECONOMIC EFFICIENCY

Cuba's other big hope for economic recovery is the creation of the economically efficient socialist firm, but Cuba has not taken the measures to ensure economic efficiency.

Some Cuban officials might take exception to that last statement. Cuba is in the midst of a campaign to promote efficiency and perfect the socialist firm. Be-

tween November 15, 1998 and January 24, 1999 eleven issues of the business newspaper *Opciones* ran two-page spreads on the new rules for business perfection.¹⁰ A major effort is being made to train accountants and introduce accounting to state firms after a 40-year absence. Wages are being tied to a firm's profitability in some cases, although the connection is apparently a collective reward rather than one based on individual performance. State enterprises are slowly being converted to corporations that are to pay taxes rather than make arbitrary contributions to the government. Giant holding companies, such as Cubalse, Cimex, and the military's Gaviota, are expected to compete against each other in many fields. Given where Cuba industry started, this is a commendable exercise. It should increase efficiency.

I do not have the perspective of time nor the hard data to evaluate the success of this effort. My observations have to be those of a foreigner living in Havana, and in those anecdotal terms the evidence of success is not obvious. Cimex is viewed as a relatively businesslike company with decent service by many in the foreign community. Cubalse is not, and most state holding companies that are supposed to compete with each other for the consumers' business still have no concept of service. There is no advertising or even telephone yellow pages to allow for comparison shopping that might force competition. The principal exercise gym closes on the weekends just when most people might want to use it. A new shopping center near the main tourist hotels closes most of its shops at six just when most customers might have time to shop. The products of the joint-venture

6. Calculated from Cuba's own statistics. The net value added for the industry in 1997 was approximately 530 million dollars (29 percent of total revenues). Direct tourist revenue earned by the Cuban Government would have been less. Total gross domestic investment is the author's estimate.

7. Cuba's dual exchange rate makes it difficult to compare different peso-denominated statistics, because there is usually an undocumented foreign exchange component. On August 13, 1999, the trade exchange rate was one-to-one while the rate in the exchange houses—primarily used by tourists and private dollar holders was 22 pesos = one dollar. That most of the tourist revenue is in dollars probably makes its impact on the economy somewhat larger. The author's own very rough estimate of a purchasing power parity per capita income is one thousand dollars. Cuba's GDP would therefore be approximately 11 billion dollars. Net tourist revenues would then constitute 4.5 percent of GDP.

8. "Income increases for 10th consecutive year," *Granma Internacional* (March 1999).

9. One prominent foreign economic observer has argued privately that associated with every licensed *cuentapropistas* there are five other employees.

10. The rules were approved in August 1998.

French bakery that received international attention when it opened two years ago continue to deteriorate because the government will not allow the importation of quality inputs. The highly profitable dollar stores continue to have trouble stocking their shelves. Light industry is supposed to be recovering, but even the Cuban press reports the quality is poor. The limitations on foreign publications, on travel and use of the Internet make it difficult for professionals to keep current in their fields. Foreign executives report the dual exchange rate system appears to be beyond the expertise of inexperienced auditors.

But let me give the Cuban effort the benefit of the doubt. Let me assume it is simply a long learning curve after which these state firms will achieve some measure of efficiency. Even if the Cuban Government achieves all its goals, these firms will only be efficient in terms of the external economic parameters they face.

Cuba has not taken the measures to establish the parameters of efficiency. In Cuba the key price parameters are badly distorted. The government administers many prices, rations foreign exchange, and grants firms only limited, albeit increasing, flexibility to set wages. Suppose state firms become efficient in terms of current parameters. There is no certainty that they would be efficient or even viable once the Cuban economy becomes open to true domestic and international competition. Cuba has a dual exchange rate policy. There is a one-to-one dollar exchange rate for most trade items and inter-firm-government accounting. For tourists and remittances there is a floating rate, currently 22 to one. The current policy is preventing the reactivation and development of industries that might really compete with imports. The foreign exchange rationing system provides other enterprises with cheap inputs that belie their true costs.

Cuba needs to devalue the one-to-one rate and unify it with the tourist rate. It needs to eliminate administered prices and free wage rates to reflect the true cost of labor. This is not easy. It will require considerable adjustments in the budget, which may be part of the reason Cuban authorities have not moved forward. However, this is pure economics 101, and is the basis for sustained economic growth and serious reform.

Cuba has not taken the measures to develop an efficient capital market. Economic growth requires choosing the right projects for investment. That requires efficient capital markets. The banking reforms that have taken place so far have been useful and necessary, but they do not go far enough. Anecdotal evidence is that political direction still affects many bank loans. Apart from such direction there is reportedly a general conservatism in lending where the ability to pay back is the prime concern rather than risk adjusted rate-of-return.

Perhaps more importantly, the reforms so far have been directed only at the lending operations of the banks. Little has been done to mobilize savings. Continued discussion of confiscation of large bank accounts to deal with a perceived problem of a monetary overhang does not encourage savers. Nor do three percent interest rates on dollar bank accounts make sense when the government is paying 15-24 percent on foreign loans. Banks need to compete for deposits if they are going to draw savings out from under mattresses.

The decision to allow firms to retain part of their profits for reinvestment was a good one. Unfortunately, the Government has not fully implemented the decision. Although profits are now often retained in corporate accounts, even the joint ventures report they must seek Ministry approval before spending any significant amount. And if a firm cannot use its retained profits internally, there is no way for it to lend or invest in another firm. Faced with few options, the firm will often invest in marginal ventures rather than return money to the national treasury or leave it fallow in a bank account. Havana is becoming full of beautiful and expensive restaurants that are usually empty.

AGRICULTURE

Of all the problems in the Cuban economy, the state of agriculture is the most problematical.

Cuba has yet to take adequate measures to rationalize the sugar industry. Sugar is by far the biggest problem. The 1997/98 crop was the smallest in fifty years. The Cuban Government has not published the actual value of sugar exports, but they probably did not exceed 550 million dollars. On that basis, one for-

sign sugar expert estimated the true loss to the economy at 450 million dollars. The 1998/99 crop was somewhat better and the government claims to have reduced costs. There is an effort to move away from maximizing production and instead to concentrate on increasing efficiency. The government has tried to limit the cutting of immature cane and claims to have decentralized management, but inputs are still centrally purchased and distributed—in inadequate quantities. Cane cutters are now being paid by the quantity of sugar in the cane rather than by weight, but wages are still very low. One of the most striking observations of a trip to the Cuban countryside is the absence of workers in the cane fields even during harvest. Presumably work is eventually done, but there is little evidence that the government is able or willing to mobilize the labor force required for harvesting or planting.

Cuba can no longer hope to solve its sugar problems on its own. It is possible that it no longer even has a competitive advantage in the crop and that with low international prices it should decrease production even further. At a minimum, the industry needs capital to replace ancient sugar refineries and needs to find a way to motivate its workers. So far the government has rejected the possibility of direct foreign involvement in sugar production, although they have expressed interest in investment in sugar by-products.

An early turnaround to these problems seems unlikely. There seems little prospect that a foreign investor would want to spend the money on a new refinery if it did not also have control over cane production. For the Cuban Government it could be very difficult ideologically to allow a foreign firm to take over the cane plantations and develop its own set of wage incentives and land tenure.

It is not even clear what is the best type of land tenure. Most production comes from the UBPCs, the Basic Units of Cooperative Production, which in turn were once state farms. By all accounts they have

not worked well. The Cuban Government calls them private cooperatives, but they are still very much a collective operation that depends on the State for inputs and subsidies. Could these be divided into private plots? Would the rural laborers that provide the labor force for the UBPC's be willing and able to become successful private farmers? Do they know anything about general agriculture or are they simply specialized rural labor? To allow for profitable mills would they all be required to produce sugar? There is reportedly pressure within the Government and from the sugar cooperatives to allow a greater proportion of the land to be used for other crops and animal husbandry.

I pose these questions not just for the current Cuban Government, but also for the future transition. According to Cuban Government figures, the sector provides 420,000 jobs.¹¹ That probably translates into over a million people whose livelihood depends at least in part on the industry. When the transition finally arrives, these people will want and deserve to participate in what we all hope will be a new prosperity. If they do not, we can expect a mass migration to the cities. It is already a problem held in check by identification cards and the police. Such a solution will not be acceptable in a democratic Cuba.

Unfortunately I have no answer for these questions. There has been a lot written on the industry, but my own limited review of the literature suggests most of it is descriptive and focuses on the current or past organization of the industry. This is an area that requires more prescriptive research and discussion among experts on Cuban agriculture and sugar economics. The reorganization of this sector is rightfully the prerogative of the Cuban people and those who work in the sector. However, if major and perhaps irreversible mistakes are to be avoided, there needs to be at least a consensus on the nature of the problem long before the transition begins to take place. It is subject worth a conference of its own.¹²

11. Radio Rebelde, "Straight Talk," March 18, 1998. According to another source, only 300,000 work directly in the industry, with an additional million working in industries related to that industry. "Esperanzados en recuperación del azúcar," *Economics Press Service*, Año 11, No 24 (December 31, 1999).

The Cuban Government has not taken measures to deal with its food problem. Aside from the re-establishment of the farmer's markets in 1994, Cuba has done little to increase food production. As in so many other of the country's economic difficulties, the State's attempt to control the industry is the problem. For many crops the State has maintained a complete monopoly. Even the country's private producers must sell virtually all of their cattle, eggs, milk, cheese, tobacco and coffee to the State at well below market prices. For other products the farmer is usually required to sell 70 percent of production to the State *acopio* system (the system that sells agricultural inputs and buys production) at well below market prices. The result of course is that the farmers' marginal cost of production is often well below the free market price for his goods. Simple economic analysis suggests that the Cuban Government could reduce food prices in the farmers' markets by eliminating compulsory deliveries and by paying market prices for the food it needs.

From the Cuban Government's perspective, however, the change may not be so simple. Leaving aside ideological concerns, there is a major budgetary problem. The current agricultural system essentially imposes a heavy tax on the agricultural sector to finance other activities, including the social safety net provided by ration cards. Paying the farming sector the full price for its product—and charging full price for the cost of inputs—will require a rebalancing of the budget. In the short run this may cause a budget shortfall. In the long term however it may save money. The failure of Cuba's agricultural policies has required ever larger food imports and it is at least possible that the tax on agriculture may now cost more revenues than it generates. This is a reform that

would best be done before an overall transition when the political turmoil will make raising alternative revenues more difficult.

In this sector as well the government has not dealt with the UBPCs. An article in the Cuban-published *Economics Press Service* last year reported there was consideration of converting the UBPCs into CPAs, the Animal Husbandry and Agricultural Cooperatives.¹³ The latter currently consist of private farmers who joined to farm collectively, but who can no longer withdraw from the cooperative. The article goes on to suggest that before making such a change, someone take a close look at the CPAs, whose performance has been less than desirable.

My view is the Cuban Government ought to convert State farms and UBPCs to individual farms within and without the Credit and Service Cooperatives and allow the latter greater freedom in using hired labor. This is sure to come with the transition, but food relief for the Cuba people is needed now.

MEASURES FOR NOW AND THE FUTURE

To this point the measures I have discussed are mostly measures that require current attention, even though they have implications for the transition if not addressed now. There are however two measures that are best addressed in the immediate context of the transition.

The Social Safety Net

One of my biggest surprises during my 22 months in Cuba was the failure of the government to protect its much-publicized safety net. It is understandable that there has been some cutback due to the lack of resources during the "special period." It was rational to reduce the number and quantity of food items on the

12. For the economist, there are several formulations of the problems. At one level it is simply to what extent sugar is still the most profitable crop if the land is distributed in a manner most optimal for sugar production. A more difficult and more realistic formulation would assume: (1) that sugar production enjoys considerable economies of scale and that the degree of concentration of around the mill is a factor in the production function and therefore in profit maximization; (2) that given centralized direction from the sugar mill, the sugar production functions of individual farmers are identical; and (3) that the production functions for other agricultural crops could differ greatly among individual farmers. Under such assumptions one would then ask if there is a Pareto optimal distribution of land which would maximize total farm incomes. A Pareto optimal solution is one that in theory at least those farmers that might have fared better under alternative land distributions could be compensated so that at a minimum they would be no worse off under the optimal solution. For the political scientist, the question is what types of land distribution will be politically acceptable in a democratic Cuba.

13. ¿A quién miran las CPA,?" *Economics Press Service*, Año 11, No. 11 (June 15, 1998).

ration card as food became available for retail purchase in the farmers' markets.

My concern, however, is the lack of attention to the most needy in the society. Medicines are scarce, not because of the U.S. embargo, as the Cuban Government often alleges, but simply because the Cuban Government has not allocated the money to buy medicines. Cuban imports of medicine dropped from 54 million dollars in 1990 to 18 million in 1996, when they totaled less than one-half of one percent of all imports.¹⁴ With most pensions well below 100 pesos/month, hunger and malnutrition are major medical problems, especially among the elderly. Underweight babies are still a regular feature in maternity wards, although the situation has improved somewhat since the worst moments of the special period. The government has recently tried to address these problems by increasing the numbers of restaurants serving the most vulnerable and increasing the food allocated to them. It is too soon to know if the new efforts are effective or the quantity of resources supplied are sufficient, but one still wonders why the government did not choose a more efficient method of simply raising pensions or providing special cash supplements for expecting mothers.

Despite today's problems, however, the social safety net remains very important to the Cuban populace. Even given the reduced value of the services provided, Cubans fear its loss and the current regime uses that fear to maintain its hold on power. In any transition, maintenance of the social safety net will be a political as well as a social necessity. It will also make other reforms easier.

Maintenance of the safety net will require substantial budgetary resources. The government ration card, workplace and school cafeterias, and old age homes, along with medical care, make up a large part of the country's social safety net. In 1998 these items, along with education and the government's contributions

to social security, comprised 46 percent of the budget. A move to market-determined prices is likely to raise the cost of these programs by several multiples and it is not clear how they will be financed.

Conceptually this is not very different from actions any government must take following a devaluation and structural reform. I note, however, that in the economic history of Latin America such adjustments have been difficult. In Cuba the problem is likely to be even more difficult. In 1997, Cuban budget expenditures were 54 percent of GDP.¹⁵ In comparison, Brazilian budget expenditures in 1997 were 14 percent of GDP.

These numbers are far from exact, but they are illustrative of the size of the problem. Financing the social safety net will be an immediate problem for any transitional government as well as for potential donors.¹⁶

Compensation for Nationalized Properties

There is one other topic that needs addressing. Rapid economic recovery, and with it social and political stability during the transition, will require a timely solution to the problem of confiscated properties.

Cuba will likely be the recipient of considerable foreign private inflows when the transition comes. Cuban citizens will also want to start and expand their own businesses. All investors will need clear title to property. I will leave it to others to discuss the varied legal and political questions as to who should be compensated, the formulas for compensation, and the possible sources for funds. I will make a plea, however, that the highest priority be given to decisions as to who should receive title and that such titles be granted quickly. Any attempt to tie individual compensation to resolution of individual property titles—as has been done in Nicaragua—is likely to seriously delay economic recovery. This issue too requires a lot more work and I recommend it as a subject for future discussion at ASCE meetings.

14. *Anuario Estadístico de Cuba 1996*.

15. Calculated from Banco Central de Cuba, *Economic Report 1997* (May 1998).

16. Price changes can of course work both ways and price rationalization might reduce the need for subsidies to state firms. Those are projected to be 30 percent of revenues in 1999. Also, given a peaceful transition, tourism is likely to boom and with predominant government ownership of hotels there is likely to be a windfall in revenue. At this point the net effect is unknowable, but with considerable economic and political tumult likely, the danger of large deficits is highly probable.