

# ECONOMIC REFORMS AND SOCIAL CONTRADICTIONS IN CUBA

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Cuba is a land of contradictions. People have no money, but no one goes hungry. Buildings are crumbling, yet Havana is one of the most beautiful cities in the world. It rains when the sun is shining, and the streets are full of antique cars that should have died years ago. Cubans continue to risk their lives at sea trying to reach Miami on handmade rafts, yet people on the island seem to survive somehow. Life does not appear to follow an orderly pattern, yet everything seems to move along.

The Cuban economy and economic reforms are just as difficult to understand. The economy shrank by 40% in the early 1990s, following the collapse of the USSR. The United States has tightened the embargo on Cuba, making it even more difficult for Cuba to acquire food, technology, and investment capital from abroad. However, Cuba's economy is slowly recovering and Fidel Castro seems to be as in control over it as ever.

Over the past decade Castro has instituted reforms that seem to move Cuba towards a market economy. Although Cuba is still very much a socialist country, economic necessity has forced Castro to allow many previously-banned activities, such as foreign invest-

ment, the use of dollars, and most importantly, self-employment. Still, Castro adamantly denounces the evils of capitalism and insists on Cuba's resolve to stay the socialist course.

This paper will examine the inherent contradictions that the newly-authorized reforms cause within Cuba's ideological socialist state. It will show that even though the economy is improving, Castro's economic policies and fear of capitalist reform cost the Cuban economy billions of dollars annually. Finally, the paper will examine the possibility of co-existence of capitalism and socialism within Cuba.

The paper comprises six sections: crisis period, economic reforms, economic success, immediate problems, long-term problems, and the future of Cuba. The paper as a whole presents an overview and analysis of the events precipitating the current economic and social situation and their potential implications for Cuba's future.

## CRISIS PERIOD<sup>2</sup>

Although the USSR did not officially withdraw its support until September 12, 1991, the Cuban economic crisis was precipitated by cutbacks in trade and subsidies from the USSR in 1989. In the period from 1989 to 1993, Cuba's GDP fell, according to

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2. The crisis experienced by Cuba upon the downfall of the Soviet Bloc is well described in the literature and will only be summarized here. The reader is referred to, e.g., *Cuba After the Cold War*, edited by Carmelo Mesa-Lago, 1993, for additional details.

different sources, between 35 and 40%.<sup>3</sup> Imports fell, due to the end of preferential trading with the USSR, by 75%. Employment declined from 4.4 million to 4.1 million, and real wages fell almost 40% in urban areas. Consequently, personal consumption declined by 15% each year until 1994 (Pérez-López, 1995:126-135). The problems created by the crisis were exacerbated by immense foreign debt, which greatly limited Cuba's ability to secure financing for trade and investment activities.<sup>4</sup> Cuba has expressed willingness to negotiate debt payments, but claims it will not be able to pay off debts without receiving fresh loans first.

Another element of the crisis is that Cuba's physical infrastructure is obsolete. For example, Cuba is stuck with Soviet Bloc machinery and technology that are impossible to repair because they were manufactured with parts incompatible with modern day, Western made parts. Cuba desperately needs capital to modernize its factories, mines, sugar mills, hospitals, and other potential sources of hard currency. However, because of its foreign debt as well as its terms for joint ventures and lack of management experience, Cuba has been unable to secure loans or to attract substantial amounts of foreign investment.

This economic crisis prompted the government to institute in the early 1990s certain reforms that altered the economy and the prevailing social ideals. The first and most drastic measure was a strict rationing of energy and food items. In 1990, Castro announced a shortfall of 3.3 million tons of oil, about a third of annual consumption. To deal with these shortages, Castro reduced gas and oil deliveries by 50% to the state sector and 30% to the private sector, reduced the number of public buses, imported 1.2 million bicycles from China, temporarily shut down several cement, nickel, and textile factories, and implemented a series of electrical blackouts throughout the country (Pérez-López, 1995: 136-142). Castro also implemented a *programa alimenta-*

*rio* whose aim was to conserve food supplies while increasing internal production. Food rations were cut in half and thousands of workers were removed from bureaucratic jobs to help in the harvests of coffee, sugar and other staples.

#### FOUR MAJOR ECONOMIC REFORMS

Having halted the economic crash by cutting consumption and reducing public expenditures, Castro initiated changes in the middle of 1993 meant to bring the country out of the crisis. Although some of these reforms appeared at the time to be pushing Cuba towards a market economy, it is clear now that they were meant to maintain socialism rather than serve as the first steps of a transition to a market-oriented economy. While some members of the government, and numerous economists in and outside of Cuba, advocate further reforms such as those that have proven successful in China and Vietnam, most members of the Communist Party, including Castro, see those countries as having abandoned socialism, which the Cuban government is not prepared to do.

The four major economic reforms instituted by Castro in 1993 are: (1) liberalization of foreign investment; (2) breakup of state farms and creation of farmers' markets; (3) dollarization of the economy; and (4) legalization of self-employment. These reforms have resulted in some economic growth and appear to be pulling Cuba out of its crisis, though GDP is still well below 1989 levels. However, they clash ideologically with socialism and are not structurally consistent with capitalism. Most importantly, they have created a variety of contradictions that threaten to undermine communist control and undo the successes of socialism.

To understand these contradictions, it is necessary to briefly analyze the four reforms. The four reforms are inherently connected and thus should be studied together rather than viewed as separate entities. Likewise, it is impossible to attribute any social contradiction solely to a single reform. For example, Castro

3. The period of economic crisis has often been referred to by Fidel Castro as *el período especial en tiempo de paz*.

4. In 1990, Cuba's debt reached \$7.3 billion (Mesa-Lago, 1993: 201). It has reached on the order of \$12 billion (principal and in interest), not counting outstanding—and contested—debt to Russia as successor state to the Soviet Union.

likes to denounce the liberalization of self-employment since it has had the most visible economically beneficial effect, especially for those individuals who have found ways to work independently of the state. However, without the increase of tourism due to foreign investment, and the dollarization of the economy, self-employment would not have been as economically successful as it has been.

### Foreign Investment

Not being able to trade sugar at subsidized prices, Cuba was forced to find new ways to obtain foreign currency. However, Cuba does not have the resources or capital to build up its tourism, nickel, or biomedical technology industries, and thus was forced to invite foreign investment in joint ventures with the government. Although foreign investment was legalized in 1982, it wasn't until the 1990s that many sectors of the economy were open to investment. Although Cuba is still considered a risky country to invest in, it has given several legal rights to foreign investors, including, among others:

1. Joint ventures are guaranteed autonomy and can freely choose their boards of directors, establish prices, define the nature of their products, etc. (although there are frequently contractual time limits for these rights). The right to hold property, within certain limits, is guaranteed for foreign investors;
2. Joint ventures are able to transfer earnings abroad in convertible currency;
3. Joint ventures are subject only to a 30% tax on profits and a 25% tax on the payroll of Cuban citizens.

Despite Cuba not being included in the top 100 safest countries to invest in, it has attracted over 300 joint ventures, of which about 200 are with smaller businesses. In addition, fourteen U.S. companies, including AT&T and Coca-Cola, have signed contracts to invest in Cuba once the U.S. embargo is lifted (Pérez Villanueva, 1998: 26).

By 1998 Cuba had attracted \$1,756,900,000 in foreign investments, with another \$4 billion committed or in discussion. Although last year the Minister of Labor and Social Security reported that only 3-4% of Cuba's 4.5 million workers are employed by foreign firms, investment has sparked production and growth in several important sectors of Cuba's economy. For example, nickel production with the aid of Canadian firm, Sherritt International, has grown 44% above 1989 levels reaching 68,000 tons. Likewise, oil production has increased by 150% since 1991.<sup>5</sup>

The majority of foreign investment is focused on the nickel, petroleum, biotechnology, and tourism industries. It is tourism, though, that is expected to make the greatest contribution to the economy. The tourism sector in Cuba, which had been small prior to 1990, has grown at an astounding 20% annually since 1993, compared to the regional average of only 6-7%, putting tourism as the top source for foreign currency. In 1997, the government reported that tourists spent \$1.54 billion on air travel, accommodations, national products, and food. Additionally, millions of dollars were spent in the emerging second economy (the legal economy that is heavily controlled by the state but runs primarily according to free market rules) in *paladares*, apartments, taxis, souvenir sellers, etc. In 1998, an estimated 2 million tourists traveled to Cuba, and by 2010 the Cuban government expects to attract up to 10 million foreigners to the island who will spend \$5 billion (Godínez, 1998: 51).

Sol Meliá, a large Spanish hotel firm, has led the way with 11 hotels in Cuba offering 3568 rooms. The investment has been lucrative for Sol Meliá; while it only has 4% of its hotels located in Cuba, they represent almost 10% of the company's earnings. Sol Meliá employs 21,000 Cubans while its Cuban partner, Cubanacán, employs an additional 20,000 (Godínez, 1998:53-58). With the recent addition of Meliá Cohiba in Havana, the only hotel on the island

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5. However, domestic production still accounts for only 17% of the national consumption and Cuba spends \$1.2 billion per year to import oil (Werlau, 1998:204-208).

that rivals the elegance of the Hotel Nacional, Sol Meliá is in an excellent position to continue to benefit from the expected tourist explosion on the island. It is important to remember, however, that while Sol Meliá manages these hotels, it only invested and owns 33.5% of them. By Cuban law no foreign firm can own more than 50%. Thus, Cubanacán invested 50% along with an additional investment of 16.5% by private Spanish investors. Although the investment has been profitable for Sol Meliá, these restrictions on ownership discourage some potential investors.

### Agricultural Reform

In addition to having to compete in a world market for goods, Cuba faced an agricultural crisis that demanded immediate reform. Because of the inefficiency of large state farms, Cuba has had problems producing enough food to feed its 11 million inhabitants and has relied on a rationing system to supply the basic necessities. After 1990, the government was forced to cut the already meager food rations in half, thus causing major public discontent while sending prices on the black market soaring.

Castro took two main steps to increase agricultural output: (1) he broke up state farms into agricultural cooperatives; and (2) he created farmers' markets to sell off part of agricultural production. The large, inefficient state farms were broken into smaller cooperatives. Although these cooperatives (UBPCs) existed before 1993, they employed only about 1.5% of the working population. As of 1996, 10.5% of the working population belonged to a UBPC and 67% of agricultural land was farmed by non-state workers (Fernández Tabío, 1998: 2-5). UBPC farmers are given more freedom than state farmers and their salary is contingent on the amount harvested. UBPCs have drastically increased food production in Cuba. In 1996, UBPC Amistad Cuba Laos, a co-op studied by Fred Royce, produced 59.2 metric tons of sugar cane/hectare, compared to the state farm average of

32.5 tons/hectare. The standard of living in UBPCs is higher than on state farms. Co-op workers were paid an equivalent of 14,282 pesos/year in cash and food products (Royce, Messina, and Alvarez, 1997:461-467). The national average for state workers is around 2500 pesos/year. Although the UBPCs are not as liberal as many reformists pushed for (the farmers are still told what crops to produce and they have to sell a set amount to the state) their creation is regarded as a step forward, albeit one motivated by the need for economic reform.

In September 1994, Castro announced the opening of the *mercados agropecuarios* (MAs), a market where farmers could sell surplus goods to the Cuban people. Cooperative farmers were assigned an *acopio*, i.e., a set amount of products that they had to sell to the state at a fixed price. Whatever they harvested beyond their *acopio* contract they were able to sell in the farmers' market.<sup>6</sup>

The MAs have been a major success. Within a year of their legalization almost 300 MAs had been formed across the country. Currently, over 25% of the nation's food supply is sold through these markets (Espinoza, 1996: 63). This is a high number considering that farmers are only allowed to sell crops in the MAs after they have produced and sold to the state the set amount required. Thus, since any surplus crop can be sold at the MA, there is a large incentive to produce more than what is required by the state. The government has also benefited. Income earned by food vendors is taxable, thus providing the government with additional revenue. MAs also soak up a small portion of the workers cut from their jobs between 1990-93, and limit the growth of the black market, which is not taxed by the government. In addition, the MAs boost food production and provide a wider range of products to the Cuban people.<sup>7</sup> This said, only an estimated 20% of the population have the money to purchase goods on the market and until recently many people complained about unreason-

6. Castro had been adamantly opposed to farmers' markets, and after legalizing them in the early 1980s, shut them down later, saying, "The liquidation of the MLC's (farmers' market) is the beginning of the end of the weeds that are the remnants of capitalism" (Espinoza, 1996: 57). Yet in 1994, he reopened these markets in response to public demand, in a victory of economic necessity over socialist ideology.

ably high prices. Regardless of these complaints, the MAs are always crowded from 7AM until 4PM, and stands are almost always empty by the end of the day.

### Dollarization

Since dollar transactions commonly took place on the streets before 1993, the legalization of foreign currency was more of a decriminalization than a legalization. Dollars fueled the black market for years before their legalization in 1993.<sup>8</sup> Still, the dollarization of the economy has had the most profound effect on Cuba and has pumped millions of dollars into Cuba's government. As I discuss later, this reform also clashes with socialist ideals more than any other reform, and evidence of the problems that dollars cause in Cuba is everywhere. This reform shows another shift in the government's policy from ideology to economics.

The reason to legalize dollars was simple. Cubans receive hundreds of millions of dollars in remittances from relatives living in the United States. In 1993, when possession of dollars was a criminal offense, an estimated \$250 million was sent from the United States to relatives in Cuba. By 1997, that figure reportedly grew to over \$700 million (Mesa-Lago, 1998: 22). With the legalization of the dollar, and greater circulation of this currency, the government has been able to capture the majority of this cash flow. Last year sales in dollar stores reached \$1 billion.<sup>9</sup>

With the increase of tourists, remittances, and the emerging middle-class Cubans, the demand for more consumer products and food prompted the government to build hundreds of new stores, malls, fast food restaurants, night clubs, etc that cater to those that hold dollars. A dual economy arose almost over-

night with the legalization of the dollar, and there is a marked difference between Cubans with dollars and those without.

### Self-employment

In 1993, the Cuban government legalized self-employment in 140 occupations and, in 1995, reinstated *paladares* (small restaurants located in the proprietor's house) and permitted professionals to engage in self-employment in fields other than those in which they were trained. This reform is clearly the most market-oriented reform, and has drastically changed the way many Cubans work and live (Peters, 1997: 2).

The decision to liberalize self-employment was made due to economic necessity and, once again, contrary to past decisions by Castro. Without the \$5 billion a year subsidies from the USSR, Cuba could no longer afford to employ 4.4 million workers in large, inefficient state industries. Thus, employment declined to 4.1 million workers, with 300,000 unemployed. Self-employment has virtually filled this void, with between 200,000 and 300,000 people registered for legal self-employment in 1996. In that year, including farmers, 23% of the work force was not employed by the state. This is a drastic change compared to the 1989 level of 5% (Fernández Tabío, 1997). Self-employment has also precipitated the formation of a tax system, and the government collects millions of dollars annually from these taxes. Despite these economic benefits to the state, the government has been shutting down self-employed workers, raising their taxes, and harassing individuals that are becoming successful. In fact, official self-employment fell over the past few years to between 150,000 and 200,000.<sup>10</sup> Additionally, the number of legal *pala-*

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7. I, for example, shopped in the MA to find spearmint leaves to make *mojitos*, a Cuban drink made famous by Hemingway, for my host family. Spearmint leaves are not a necessity, and before the creation of the MA this mint would be almost impossible to find, making *mojitos* a drink enjoyed almost entirely by tourists.

8. In 1993 the dollar was selling for between 125 and 140 pesos, six or seven times the official exchange rate now, 22 pesos to the dollar. The Cuban government makes it easy to trade in dollars for pesos but very uneconomical to trade in pesos for dollars.

9. Castro has instituted several measures to capture dollars. Several years ago the national bank issued a convertible currency that is guaranteed to hold the same value as the dollar. Thus, many government dollar stores will make transactions in convertible currency. The government can hold most of the dollars to use for foreign trade while the convertible currency is used for internal transactions.

10. As discussed below, almost every Cuban relies on some form of clandestine self-employment.

*dares*, which are popular with tourists because they serve authentic home-cooked Cuban food, has dropped from a couple hundred to around 25.<sup>11</sup> The government has been especially strict on *paladares* because they divert tourist money away from state-run restaurants and in to the hands of individuals.

Even with the recent decline of self-employed workers it is impossible not to notice the impact that self-employment has on Havana and the rest of the country. Every block hosts ice cream sellers, taxi drivers, snack stands, mechanics, plumbers, barbers, etc. Illegal activity flourishes as well. Every morning people rang my doorbell selling eggs, air fresheners, chicken, lobster, and appliances.<sup>12</sup> Their prices were usually well below the market price. Much of the food consumed by Cubans comes from these illegal transactions. CD's, rum, and tobacco can also be easily purchased on the street.

I spoke with many *cuentapropistas*, and several of them agreed to share with me the details of their business, taxes, profits, ambitions, and way of life. These four cases are common stories and represent the lives of thousands of Cubans.

**Bike Taxi Driver:** David moved to Havana about 5 years ago without a job and without much money. He bought his first bicycle taxi shortly after arriving, spending all of his savings. A year later, he was able to buy a nicer bike for \$125. At the beginning of each year he pays \$102 for his license to be self-employed. This annual tax also covers his insurance. Every month he has to pay an additional \$24 and at the end of the year he has to pay income tax if he makes over a certain amount.

David works six days a week to support his wife and child. For most rides he charges \$4 to \$5 and he serves as a guide for \$10/hr. (However, to fellow Cubans, he is willing to give rides for much less.) David spends most of his time in front of the Hotel Nacional with five other bike taxi drivers. Some days he

doesn't give a single ride. Other days, he can give as many as seven. David makes up to \$150 a month after taxes, which is about ten times what he could make working for the state. David is part of the emerging middle class of Cubans. He can afford to go to bars with his co-workers, buy clothes in dollar stores, and live in a nicer part of Havana. His entrepreneurial ethic is clear, as he works up to 80 hours a week.

**Peanut Seller:** Peanut sellers swarm the *Malecón* (the oceanfront walkway), movie theaters, and restaurants. I spoke with an old woman that sold peanuts outside my apartment. She is retired and sells peanuts everyday to supplement her 50 peso/month pension (about \$2.50) from the government. She has to support her 33-year-old son who is mentally retarded and cannot work, although he does receive a small pension and free medicine.

Every day she fills 34 packets of peanuts, which she will sell for 1 peso each. She has to buy two pounds of peanuts at 9 pesos/lb in order to fill these 34 packets. Thus, if she sells all her packets, her daily profit is 16 pesos, or 80 cents. Although this seems like a small income, assuming that she sells all her peanuts every day, she would make close to 500 pesos a month, twice the average salary of state workers. One afternoon she told me, "We didn't have much luck with Batista. I was very poor. But then the revolution came and helped us, taught us. What can you do but accept it? Step by step, a little money here, there. We get by alright." Talking to many Cubans I heard a similar sentiment over and over.

**Room or Apartment Renter:** These are generally the wealthiest of all the self-employed, and supply large revenues for the government. Most people rent out rooms at \$15-\$30 a night. These are people who had large houses or apartments before the revolution and were able to keep their houses after 1959 because they were on favorable terms with the Castro administration. My host family, with whom I stayed for a

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11. It is obvious, from the numerous individuals that approached me in the streets asking if I'd like some home cooked food, that many of the *paladares* that were shut down by the government continue to operate on the black market.

12. A good friend that invited me over for dinner bought eight pounds of lobster at \$1.50/lb, \$4 to \$5 below the market price.

month, lives in a relatively affluent section of Havana, about 5 minutes to downtown. They rent out two rooms at a time, each with air conditioning and a private bathroom. Guests pay \$20-\$25 and have access to the phone, laundry, balcony, and kitchen.

While looking for a place to stay I spoke with another very nice family in a different barrio of Havana. The mother of the family, "Carmen," a former government employee now in charge of the operation, pays \$500/month in taxes for the two rooms she rents in addition to an income tax at the end of each year, which adds another \$500. If she reported her entire income, the tax would be much greater, but no one in Cuba reports what he or she actually makes. Although a guest would pay around \$900/month to stay in one of her rooms, she only reports receiving \$500. This is a very common practice and many apartment renters do not even register with the government and lease rooms clandestinely. Carmen has developed an extensive clientele from all over the world that rent a room from her whenever they travel to Cuba, usually for business. However, during the slow months there is pressure to fill the rooms in order to meet the \$500 tax, which is assessed regardless of earnings.

Apartment renting is the most lucrative form of self-employment and many of the families that are in this business would be considered upper class. Their monthly income from leasing rooms is usually over \$500 and can be as high as \$1000 after taxes. This money affords them the luxury of having products such as TVs, VCRs, clothes, CD players, etc. that can only be bought in dollar stores. Still, they would never be considered rich by U.S. standards. In Cuba, there is only a handful of truly wealthy people.

**Food Vendor:** Government salaries make it almost impossible to survive. The majority of the people resort to another way of making money, legally or illegally, in addition to their normal job. It actually seems strange that people even show up for their official job, but there are many benefits from working for the State: all workers are fed breakfast and lunch, receive a salary, and through good work can receive bonuses or incentive packages. The biggest reason to work, however, is access to supplies and goods that

can be sold on the black market. Gas station workers sell gas covertly, tobacco rollers sell cigars to tourists, and butchers sell meat after work. Many of these goods are stolen and represent a huge loss to the state.

When two young women came to my door one morning trying to sell chickens, I spoke to them about their operation. "Clara" works in a tobacco factory and earns 156 pesos/month (\$8). "Mercedes" is a student of economics but does not believe that she will be able to find a professional job after graduation. "I just study for fun. I know that after I graduate I will have to look for a job in a factory or state company. I won't be an economist. There aren't enough jobs." Clara works Monday through Friday from 7AM to 4PM and then meets up with Mercedes to sell chickens door to door.

Both girls told me that it is impossible to live on less than \$20 a month, so they each have to earn an extra \$10/month on the second economy just to get by. Clara says that she buys chicken at 13 pesos/lb from a supplier who works at a chicken factory. The two young women sell the chickens door to door for \$5 per chicken and thus earn about \$1.50 for each chicken. Furthermore, they are able to convert pesos to dollars by buying the chickens in pesos and selling in dollars. Chicken is generally a luxury food in Cuba, and thus only the people with access to dollars can afford this food item more than once a month. The girls usually sell 10 chickens a week and make about six dollars each. I asked why they don't sell chickens full time; Mercedes answered that it was illegal to do what they were doing. If they only do it part time, to survive, the police will often look away. Everyone in Cuba, even the families of the police, depends on and realizes the importance of the black market.

### ECONOMIC SUCCESS

The four economic reforms described above have helped Cuba's economy. Cuba's GDP grew by 7% in 1996, 2.5% in 1997 (Mesa-Lago 1998: 22), 1.5% in 1998, and the government claims 6% in 1999. The value of the peso has stabilized against the dollar and the standard of living is improving.

Some reformists in Cuba argue that Cuba should look to China and Vietnam for a new economic model, but Castro refuses this more extensive liberalization. Cuba is stuck trying to hold on to a failing socialist system by instituting limited market reforms. However, socialism and capitalism cannot be mixed together easily. Socialist ideals crumble, while capitalist markets are held back by high taxes, regulations, and Castro's rhetoric against success. Thus, Castro has exchanged economic problems for social and ideological problems. The future will prove whether Castro can balance these two different ideologies, whether the new equivocal reforms will be abandoned, or whether the Leninist/Marxist regime will crumble.

### IMMEDIATE PROBLEMS

Several problems became clearly evident shortly after the initiation of the reforms. Among the most serious was an increase in crime, drugs, and prostitution. With state workers earning \$15 a month, many Cubans looked to earn a quick dollar by ripping off tourists, dealing marijuana, or selling their own bodies. Several teenagers approached me selling "ganja" for two dollars a joint. According to them it was safe to smoke pot in private houses. The next day I read in the newspaper that a man was sentenced to eight years in prison for the possession of a few joints. Prostitution is a more lucrative business. The first-class prostitutes sell themselves for \$50 a night. Although many of these prostitutes work primarily for foreign tourists, it is not uncommon for a Cuban man to solicit sex from prostitutes, although at a lower rate. Many of the women that I spoke to moved to Havana a couple of years ago. They plan to prostitute themselves for several years, save up a lot of money, and move back to their original towns. Gay prostitution is equally as evident and quite open. While standing on a corner on La Rampa I was confused for a prostitute and offered \$50 for a "quickie." I politely turned him down.

Since 1996, the government has taken several steps to combat these "evils of capitalism." Six thousand policemen were added to Havana's district in 1997-99 (Fernández Tabío, 1999). Drug trafficking and pimping became punishable by death. Prostitutes

were cleared from many tourist areas. Castro also instituted laws to protect tourists from scam artists known as *jineteros*. (This word carries bad connotation as it is also used to refer to sex traders.) Loitering is now illegal. Children must be accompanied by adults while walking the streets, and most Cuban citizens are not allowed in tourist destinations including hotels, Varadero beach, and certain restaurants.

For the first time since 1959 distinct economic classes have emerged. Workers in the private sector can earn one hundred times what state workers, who are still the great majority, earn. With the increase of wealth of a portion of Cuban citizens, a high demand for consumer products has emerged. Among Cuba's "middle" and "upper" classes, government dollar stores have been extremely popular. Last year sales reached \$1 billion. This number is significant for several reasons. First, it shows that citizens have more access to dollars than previously thought. In 1997, about \$700 million in remittances were sent to Cuban families. Thus, Cubans must have earned an additional \$300 million from tourism, the only other source of dollars into the mainstream economy. Second, \$1 billion in sales shows the propensity of Cubans to spend almost all their liquidity. With interest rates at 2-3%, there is not much incentive to save, and Cubans highly value products such as TVs, VCRs, radios, and kitchen appliances (Maybarduk, 1999: 5).

Polarization of wealth is a major concern for Castro because it is contrary to the traditional socialist belief that dictates that people should work only for the good of the country. Such a sudden and wide difference in wealth among the Cuban population has caused the increase in crime. Cubans who are worse off after these reforms are unaccustomed to seeing their neighbors with more material wealth. Inequality leads to crime. This polarization of wealth has also disillusioned many people who had remained loyal to the Revolution. People that have worked for years to support the socialist ideas are suddenly seeing themselves worse off than their fellow citizens that have engaged in capitalist endeavors. As one man, an officer in the military, told me, "I have dedicated my whole life to the Revolution. Now I see that it is all

for nothing; my life has been for nothing.” I was surprised to hear this candid response.

### Dual Economy

Cuba operates with two distinct economies, a dollar economy and a peso one. Dollars can buy peso products and dollar products, but pesos can only buy peso products. Only domestically made products are sold for pesos. Thus, Cubans who only earn pesos have little purchasing power. After purchasing the month's rations of food, a peso earner can afford some state-subsidized luxuries such as ice cream (3 pesos), cinema tickets (1 peso), and beer, (3-8 pesos). Cubans also depend on the sea for food and entertainment. Every dawn and sunset fisherman crowd the *Malecón* casting lines to catch fish for dinner. In the water children spear fish and catch lobsters and other shellfish. During the day they float on old tire inner-tubes or pieces of styrofoam.

The large majority of Cubans earn at least several dollars a month doing odd jobs or selling things on the black market. Most Cubans claim that one needs about \$25/month to survive. This means that almost all Cubans have to gain about \$10 a month to supplement the average salary of \$13/month. The population with regular access to dollars (more than \$15/month), an estimated 55%, have substantially more purchasing power than the 45% of Cubans with limited dollars (Rivera, 1998: 110). There is a clear distinction between these two groups of people and walking around Cuba they reminded me of Dr. Seuss's star bellied snitches and plain bellied snitches. The two groups eat in different restaurants, shop in separate stores, drink different beer, and wear different clothes. Almost every item has a different brand, one for dollars and one for pesos. Beer, for example, can be bought in bottles for 8 pesos. The bottled beer is called "Polar" and is acceptable to drink as long as it is cold. Beer can also be bought in cans for 85 cents of a dollar. "Cristal," "Bucanero," and "Mayabee" are all brands of canned beer and are preferable to those who can afford it. Thus, it is easy to determine which people fall into the dollar category and which fall into the peso category by the brand of beer that they drink. If a deepening of social class lines continues, it could lead to greater animosity in the future.

It is important, however, to recognize the role of subsidies in the Cuban economy. If one earns a hundred times more than another does, it does not mean that he/she is a hundred times richer. Because of food and clothing subsidies, peso earners can buy products that are worth far more than the price they pay. However, each citizen can only buy a set amount of these products. Thus, the average state workers' real income is more than \$12. After one buys the subsidized products, the purchasing power of the peso and dollar goes way down. Even for Cubans that make dollars, it is almost impossible to buy a car, eat out often, or buy many imported products.

### LONG TERM PROBLEMS

Theft from the State is a major problem in Cuba. Most items that are available on the black market are stolen from state stores, factories, and companies. The liberalization of self-employment did not cause this theft, but encouraged it by spurring the internal economy and raising demand for consumer products. In grocery store parking lots vendors sell stolen meat, cheese, and vegetables for less than they can be bought in the store. Gasoline is sold at half price by private vendors that steal it from the state.

The presence of an extensive black market in Latin American countries is not uncommon. Black market activity in Mexico, for instance, represents 30% of the country's GDP. Black markets usually arise in countries with high taxes, strong government intervention in economic activity, and large bureaucracies. Whenever the market cannot function freely, black markets arise. Cuba's black market is similar to those in other countries and could be controlled by economic reforms.

Cuba's first economy is completely controlled by the government. Many consumer products are reserved solely for exports and are either sold only in dollars or priced above the national market price in pesos. Chicken, beef and lobster, for example, are mainly reserved for tourists who are willing to pay high prices in dollars. Thus, Cubans are forced to pay exorbitant prices for these foods. Castro's goal is to discourage domestic demand for these products and sell them to foreigners for hard currency. Since there are few other producers of these foods besides the state,

the local demand is met for these foods by the black market. Workers steal chickens and lobsters and sell them door to door like the two young women that I spoke with outside of my house. This is a risky way to earn a living, and Castro has cracked down on these “traitors of the Revolution” by dealing out long jail sentences. Even with the threat of imprisonment, vendors sell their products at below state prices, an unusual outcome for black markets where prices are usually higher than market prices.

In Cuba, however, the problem is not that the supply of products is too low, but that the things produced are reserved for foreigners. Chickens are not difficult to raise and in many other Latin American countries are common and easy to purchase. In Cuba, where it is no tougher to raise chickens, their price is substantially higher (because they are reserved for tourists) while the demand is equal to that in any other country. Thus the black market supplies chickens to families willing to pay about \$1.50/lb. The legalization of small businesses would increase the supply of chickens and other products to the Cuban population while still allowing the government to sell chickens at high prices to tourists in government run restaurants.

Castro might argue that small businesses would divert products away from the external sector and to the domestic economy. This probably would not happen because the production curve would shift with the emergence of small businesses that are more efficient and have economic incentive to produce more chickens. Thus, chicken production would increase in two ways: theft from the state would decrease and production of chickens on the local scale would increase and be more efficient.

Castro is opposed to any individual success and heavily taxes all private enterprise in an attempt to distribute wealth evenly. This policy has several negative effects on the Cuban government and on the Cuban people. High tax rates reduce the revenue that the government collects because high rates discourage economic activity (the so-called Laffer Curve effect). That is, as rates rise economic activity falls. At some point, once the rate is sufficiently high, the resulting fall in economic activity reduces revenue by as much as the increased revenue on the remaining eco-

nomical activity. If tax rates are raised further, then production falls and thus profit and tax revenue fall as well.

Castro imposes a set monthly tax on all private enterprise. Apartment renters, for instance, pay \$250/month regardless of their profit. Most apartment renters rarely have more than a 50-75% occupancy rate. If a private apartment renter leases a room at \$25/night for 20 nights a month then he will gross \$500. Thus, the set tax would be 50% of revenue, not profit. Clearly, this occupation can be risky. If one fails to lease out the room more than ten nights a month, at the fairly high price of \$25, he will lose money.

High taxes also create an entry barrier for many Cubans wanting to become self-employed. Imagine the case of a state worker who wants to buy a bicycle taxi and a license to operate it as a *cuentapropista*. The start-up cost would be \$125 for the bike, \$102 for the yearly tax that covers insurance, and \$24 for the first month's tax. This totals \$251 or 21 months salary for an average state worker. To further hinder entrepreneurs, it is almost impossible to get loans from the bank. Thus, only Cubans who receive remittances from abroad, or have access to dollars from other sources, are able to enter the private market. This furthers the polarization of wealth.

Many Cubans who have limited access to dollars find ways to avoid these taxes and still work in the second economy. Some simply operate illegally. This is obviously risky, and many Cubans are thrown in jail every year for this illegal activity. The majority of Cubans, dollars or no dollars, find ways to avoid paying the full tax. Cubans who have a reliable source of dollars can afford to pay most of the taxes and reduce the risk of imprisonment, but Cubans who live primarily off of pesos are forced to find ways to evade the brunt of the taxes imposed on self-employment. This can be done in several ways, and Cubans are very creative.

The easiest way to dodge taxes is to register for a low tax form of self-employment and then operate a different business. Joseph Scarpaci in his article, “The Emerging Food and Paladar Market in Havana,” de-

scribes a *paladar* owner, “Rosa,” who is licensed to make and sell candy in her home (1995, 76-84). Selling candy is not a very lucrative business, and thus the taxes are not very substantial. Rosa proceeds to operate a *paladar* in her living room and even illegally employs other Cubans at various times to help cook or run errands. The license to sell candy allows her to explain the constant stream of people that flow through her house, and also explain her supply of oil, flour, milk, and sugar, if inspectors were to ask. Rosa also makes sure to be on good terms with the local CDR representative. If Rosa were forced to pay the full tax on *paladar* owners, she would probably not be able to afford the cost of business.

Many Cubans who do register their actual occupation do not report their full earnings. In addition to monthly taxes, the government also has instituted an income tax to limit any monetary success. However, since Castro is forced to rely on self-reporting of income, no one reports what he/she makes. A Canadian tourist I spoke with told me that the woman with whom he stayed reported that he paid her \$15/night instead of the \$30 that he gave her. She was worried that he would not approve of this action and said, “Nick, if I tell the government what I actually make, they will eat it all up with taxes. Already, at the end of the year I have to pay around \$500 in income tax. I am supposed to pay another \$500, but we just can’t afford it.” He assured her that he would do the same.

I bought a painting at the artisan market in the historic section of Cuba. After bargaining with the vendor, “Carlos,” I got the price down to \$70. We talked about the taxes on artists. Artists have recently been given more freedom than any other types of self-employed workers. Larry Corwin, an officer at the U.S. Interest Section jokes, “the thing that I like best about Cuba is that the artists are rich and the lawyers are poor.” Although this may be true, taxes are heavy on artists too. One difference is that artists

don’t have to pay a monthly fee to be artists. They are only taxed on what they sell. Carlos explained that he sells the artist’s work and makes a 15% commission on everything that he sells. Also, the artist has to pay 30% of the price of the paintings to the state to rent the stand in the artists’ market. Then, he has to pay 20% to the state as income tax. Thus, if the artist and the vendor report what they sell, the artist makes 35% of the selling price of the painting. For a \$70 painting, the artist would make \$25. Carlos, however, told me that they report the paintings’ value at half of what they actually sell it for. The painting that I bought they reported selling for \$40, so they pay 50% of \$40 to the state and are left with the remaining \$50.

By forcing Cubans to dodge taxes and participate in the black market, Castro has made criminals out of the majority of Cubans. In a land where national pride plays such an important role, this can be extremely detrimental. Since the Revolution, Castro has relied on anti American sentiment and national pride to justify many of the sacrifices that he asks his country to make. He declares that Cuba is for Cubans. Propaganda appears on hundreds of billboards across Havana: “Creemos en Fidel,” “Tenemos y Tendremos Socialismo,” and my favorite billboard located in front of the U.S. Interest Section, “Señores Imperialistas: ¡No les tenemos absolutamente ningún miedo!” Fidel constantly tries to convince people that they must give up ideas of personal wealth in order to benefit the country, and they must not give in to capitalism or they will all be slaves to the United States.<sup>13</sup> In a socialist system where incentives to work are not always apparent, Castro uses exhortations to encourage the people to work.

However, by making average, hard working citizens into criminals, Castro is creating a large split between the people and the government. No longer is the government seen as the provider for the people; it is

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13. Ernesto Betancourt writes in “Potential Impact of the Helms/Burton Act”: “His (Castro’s) rise to national leadership and international acclaim was based to a great extent on his becoming the embodiment of Cuban nationalist sentiment. The failure of the regime and the disaster it has entailed for the Cuban people in no way reduce the nationalist cravings Castro so effectively mobilized in support for his leadership role. In fact, in the fear of return to American domination, it is one of the emotional forces he still uses to rally his followers around him, especially within the armed forces” (1995, 412).

now something to be feared and robbed. National pride is falling. In the 1960s, the majority of refugees were upper-class businessmen, professionals, and landowners who fled after Castro confiscated most private property. Now, however, Cubans of all socio-economic classes are taking to rafts. A woman, from whom I bought fruit every day, asked me if I knew any older males in the United States who would like to marry for convenience. She says that she would make an excellent housewife. People constantly dream of leaving the island for Miami, Texas, or LA, and it is understandable. Who feels pride for a government that criminalizes its people? Thus, Castro is losing one of his largest political assets.

It is also difficult to support a leader who goes out of his way to crush the successful. Castro claims that it is important to divide the wealth equally; no one can be richer than his neighbor. However, in Cuba there is little wealth, and Castro makes it hard to accumulate more. Most Cubans support some of the ideas of the Revolution, but many are beginning to realize that Castro is hurting the country. In 1994, Castro shut down *paladares* because they were becoming too successful. In 1995 he was forced to re-open them. In 1986, Castro closed the MLCs (*mercados libres campesinos*), contrary to public support for the MLCs, because these farmers were making too much money. After the food crisis, Castro legalized the new farmers' markets now called *mercados agropecuarios* (Espinosa, 1996:58-63). In 1995, Castro announced that he would lay off half a million state workers to make state firms more efficient. He was forced to abandon this plan in 1996 because the private sector could not absorb these laid-off workers, in large part because of a 300% increase in the cost of business permits (Mesa-Lago, 1998). Castro prefers to employ half a million redundant state workers than to let the private sector grow. These reversals of laws make Castro look foolish and without any political platform for the good of the people. They also undermine the validity of other laws that Castro imposes.

Castro's police force regularly terrorizes individuals who attempt to earn a living apart from the state. Larry Corwin, of the U.S. Interest Section, told me that his neighbor, a retired man who had to support

two grandchildren, was thrown in jail for the weekend because he washed Larry's car for \$2.50 every week. I spoke with a crippled man who was regularly put in jail for the night because he washed cars for a couple pesos each in front of the Hotel Nacional.

Castro does have a legitimate fear that Cubans will become successful. Independently wealthy citizens in Cuba would pose several problems for the government. First, they would create pockets of power that are independent from the state. Currently, Castro's reign is not in jeopardy because there is no one who can oppose him. All political leaders are in the Communist party. Second, people with money care more about how they are governed and taxed. Revolutions rarely occur in countries where the people are totally oppressed. The United States for example, prior to 1776, was one of the wealthiest colonies in the world. Additionally, taxes paid to England were not greater than any other colony. Yet, the revolution started because Americans took a great interest in how they were taxed and whether they were taxed unfairly. Jack Greene writes in *An Uneasy Connection* that by 1773, the colonies had developed an economic and social elite, and had drastically increased the wealth and size of the colonies over the previous ten years. According to Greene, the revolution was caused by the economic elite and fueled by the growing middle-class (1973: 60). Cuba has yet to develop an economic elite independent from the Communist party, and Castro knows that economic power leads to political power.

Perhaps the biggest contradiction in Cuba today is the purpose of its current economic/political model. Castro claims that Cuba must preserve socialism and fight U.S. imperialism at all costs; socialism will preserve Cuba for the Cuban people. Anyone who has been to Cuba recently knows that the island is controlled less by the Cuban people than it ever was before the Revolution. Cubans are not allowed in many of the hotels that cater to tourists. Cubans must have special permission to travel to Varadero beach. Cubans cannot freely move to Havana because of the overpopulation of the city, nor can they leave the country without permission from the government. Citizens must carry identification at all times and are

constantly stopped and harassed by the police. My friend, Kramer, was stopped on average twice a day while he was with me because the police thought that he was bothering me, especially since he is black and I am white. Once, after being questioned by the police, Kramer said, "Charlie, you could walk up to me and break my nose and while I am on the ground bleeding the police would take me to jail and apologize to you for your swollen knuckles."

Foreigners have complete reign in Cuba and walk around on a red carpet while Cubans are made to feel second rate. This has an immense effect on nationalism, but results directly from Castro's policy. Since he refuses to allow the internal economy to grow, the dollars that the government needs must come from foreigners. One reason that Cuba has so many tourists is its competitive advantage over other Latin American countries in crime. Tourists can walk around at almost all hours of the night without feeling any physical danger. Tourists stay in nice hotels at comparatively cheap rates (the Hotel Nacional a five star hotel charges about \$100/night), eat at fancy restaurants, go to the beach, and drink exotic drinks, while most Cubans live a controlled and restricted life. It seems impossible that before 1959 the situation could have favored Americans over Cubans any more than it does now.

By suffocating the internal economy, Castro limits the multiplier effect that foreign investment can have on the local economy. This multiplier effect is the domestic business that develops in response to foreign investment. Andy Isserman, an economist at the University of Illinois, estimates that the multiplier effect in third world countries can be as high as twice the amount of foreign investment. For example, Sol Meliá invests ten million dollars into a new hotel in Havana. In an open economy, Sol Meliá would hire construction workers, artists, managers, chefs, and buy local products and materials. With this \$10 million spurring the local economy, the demand for products would rise, and growth would occur to match this new demand. In Cuba, however, Sol Meliá is forced to buy many of the products needed for construction and management from Spain. Additionally, the \$10 million investment is soaked up by

the state, which uses it to import oil, food, and medical supplies. Thus, the \$10 million is almost immediately diverted away from the Cuban economy and any potential growth is thwarted. Nicolás Crespo, in his article "Back to the Future: Cuban Tourism in 2007," estimates that in 1997, Cuba lost \$1.9 billion in the tourism sector alone, due to its economic policy. Crespo used Puerto Rico's multiplier effect in making this estimate, an island with an open economy (1998: 42-43). Thus, by 2010, with the \$5 billion dollars that is expected from tourists, Castro's restrictive economic policy would cost Cuba over \$6 billion.

Consider an actual example. Sherritt International operates a nickel mine in Cuba. Cuban law prohibits foreign companies from hiring Cuban citizens, so Sherritt contracts 10,000 workers through Castro. Sherritt pays Castro \$10,000 a year for each worker. Castro then pays each worker in Cuban pesos the equivalent of \$120 per year. So, Castro takes about 90% of the salaries paid by Sherritt and redirects it to other purposes. If Castro let foreign companies directly hire Cuban workers, then the Cuban economy would be boosted by the increase of dollars in the economy, consumer demand would rise, and producers would produce more to meet this demand. The only downfall of permitting companies to directly hire Cubans would be that the workers would not make \$10,000 a year. At first, since so many Cubans would be willing to work for even \$200 a year, companies would be able to employ workers at extremely low salaries. However, as workers developed unions, the right to negotiate directly with their employers and the government instituted a minimum wage, salaries would begin to rise.

### CUBA'S FUTURE

I do not believe that anyone can predict what will happen in Cuba over the next decade. The U.S. government is worried that with the death of Castro over a million Cubans could take to the seas to get to the United States. "The United States remains committed to promoting a peaceful transition to democracy and forestalling a mass migration exodus that would endanger the lives of migrants and safety of our nation" (White House press release, May 1997). Several

officials that I spoke with in the U.S. Interest Section believe that up to 1.5 million people might attempt to leave Cuba for the United States when Castro dies.

Although I do agree that many Cubans may try to flee Cuba with the death of Castro, I am not so sure that Cuba will turn to a free market economy with the death of Castro. Currently, there is no one outside of the Communist Party that can oppose Castro. Anyone that has any money is associated with the Party, and most dissidents now live in the United States. Those next in line to succeed Castro (Carlos Lage, Ricardo Alarcón, and Raúl Castro) are devout communists and support the ideals of the Revolution. I cannot say that Cuba will not open up within the next decade, but I believe that it will be a slower process than some think and hope.

If no further economic reforms are made I believe that Cuba will once again enter an economic crisis. Currently, Cuba depends too much on its tourism industry. Although it has been growing rapidly, there is no guarantee that this growth is sustainable. Sol Meliá, for instance, reports low return rates (about 10%). For many tourists, Cuba is a place they want to see once, to witness life in one of the last socialist countries. Without access to Cuba by Americans, it may be difficult for Castro to reach tourist levels (10 million by 2010) that the government predicts (Godínez, 1998:53-57).

Cuba will also continue to decline as a leader in health care and education. Thousands of professionals — doctors, lawyers, professors, and managers — are quitting their state jobs to join the private sector. The woman I stayed with used to work for the state as an editor of national statistics. She traveled to several other socialist countries and had a graduate degree. Five years ago she quit her job that paid 350 pesos/month to rent out two rooms in her apartment. She now makes over a hundred times what she made working for the state. I spoke with a taxi driver who used to be a captain of a trading ship that sailed around the world. Three years ago, while he was at port in Canada, he bought a used car and became a taxi driver. Cuba is suffering a huge social loss from these professionals that have received thousands of

dollars worth of education who quit to do mundane jobs that earn significantly more money.

Finally, I believe that thousands of Cubans will continue to flee to the United States. National pride is declining, and the U.S. is thought of as the land of dreams, where one can make as much money as he is willing to work for. Unless Castro is willing to make some changes, he will be governing a sinking ship. The four major economic reforms that I have discussed only managed to slow the leak, but they do not come close to keeping the boat afloat.

I believe, however, that Castro can reform the economy while avoiding complete transformation to a market economy. I think that Castro could move to an economy much like that of Denmark or Sweden. These countries basically have free markets (the governments still run the large communication and transportation companies), but provide large safety nets for their citizens. Of course, these welfare programs are expensive, but a sound economy would add more money to fund these programs. An economy similar to Denmark's would be successful in Cuba while protecting against some of the inherent problems of capitalism. To accomplish this, Castro first has to legalize small business. Small businesses would increase production, lower prices, and supply more tax revenue to the state. Furthermore, they would soak up the unemployed workers that have been laid-off from inefficient state companies.

Castro has to reduce taxes. Since the government provides many services to the Cuban people for free, it is understandable that the government has to collect a large amount of revenue. High taxes, however, is not the best way to maximize revenue. Denmark provides many of the same services to its citizens but only taxes 40% of income. Cuba could have a similar tax structure; this would encourage workers to produce efficiently, while still providing the money that the government needs.

Finally, Castro has to allow foreign companies to hire and pay Cubans directly. It is more efficient to let Cubans decide how to spend their own money and maximize utility, rather than have the government decide how to allocate these funds. If each Cuban

could spend the money that he rightfully earned, then Cuba would see goods and services being distributed to the people that value them the most. More importantly, permitting companies to hire Cubans would increase the multiplier effect, noted above. This multiplier effect could add several billion dollars annually as foreign investment continues to grow.

I was living in Costa Rica when I first traveled to Cuba three years ago. I fell in love with the island and was amazed at the cleanliness of the streets, the lack of homelessness, and the kindness and spirit of the people. Havana was a vast contrast to San José, Costa Rica, where the streets are lined with trash, people beg for money on the streets, and crime is an increasing problem. Initially, I supported Castro and his attempt to provide for the entire Cuban population. I viewed socialism as different than capitalism but not necessarily inferior.

This summer, however, I came to see the situation very differently. I still applaud the advances that Castro has made in education and health care, although I realize that this was fairly easy to accomplish while Cuba was living off of the USSR. Now, I see Castro as a dictator that cares more about preserving power and socialism than the welfare of his people.

The Cuban people are the country's most valuable natural resource and Castro is forcing them to live in relatively impoverished conditions. He is precipitating a decline in national spirit and forcing thousands of people to leave their beloved homeland. Cuba is like an adolescent boy, struggling to get its freedom and identity from his controlling parents. Soon, however, Castro will no longer be able to control the Cuban people, and like the boy, the people will not tolerate these restrictions on growth and prosperity.

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