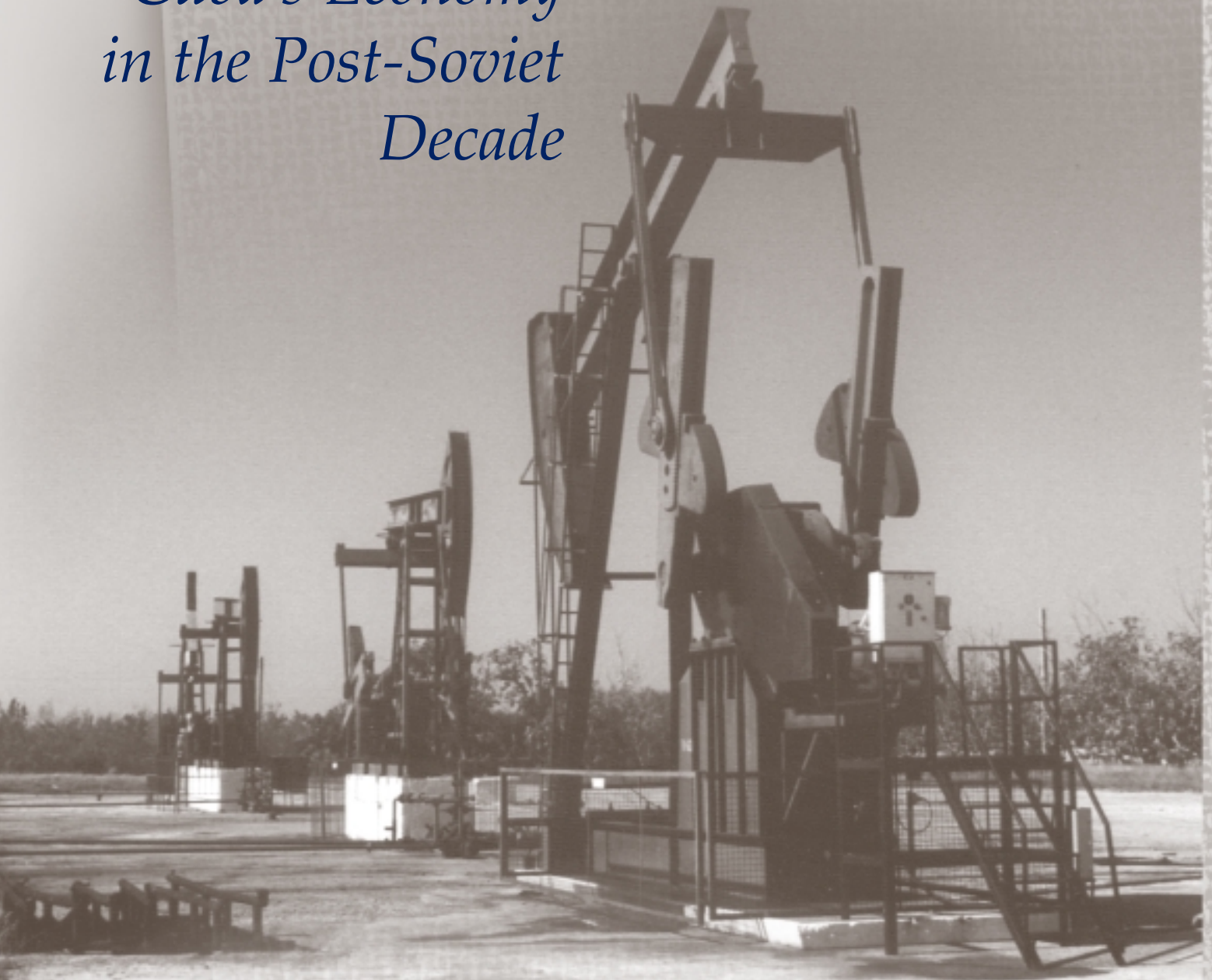


# **SURVIVAL STORY:**

## *Cuba's Economy in the Post-Soviet Decade*



Philip Peters, Vice President, Lexington Institute • May 2002







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## INTRODUCTION

One decade ago, the demise of the Soviet Union and its socialist economic bloc plunged Cuba into an economic crisis that many observers believed it would not survive.

The Soviet subsidy to Cuba's economy, one fourth of Cuba's national income, vanished. Cuba's gross domestic product fell 35 percent between 1989 and 1993. Cuban mothers tell that in the severest years of the crisis, 1992 and 1993, they gave their children a glass of water with sugar before sending them to school. Students recall wearing shoes made of tire scraps and adhesive tape. Parents allowed children to play in the street all day because fuel shortages brought vehicular traffic to a near-standstill. Factories closed; workers were laid off. Farmers replaced their tractors with horses and oxen.

In Miami, a prominent expert published *Castro's Final Hour* in 1992, a book about "the coming downfall of communist Cuba." In Washington, U.S. officials pored over intelligence analyses and tried to guess the month when Cuba would run completely out of fuel.

Yet Cuba survived the crisis and went on to achieve modest economic growth during the 1990's. This paper, based on interviews with Cuban citizens, officials, and executives, and with analysts and investors in Cuba, describes the measures behind this survival story and the challenges Cuba continues to face. More detailed analysis of some of the topics treated in this paper is found at [www.lexingtoninstitute.org/Cuba](http://www.lexingtoninstitute.org/Cuba).

Cuba's policymakers had no choice but to restructure the socialist economy, widely using markets and elements of capitalism, and adopting strategies to generate growth and income in the uncharted territory of the global market economy.



Tourism replaced sugar as the top foreign exchange earner. Foreign investors brought new capital and knowhow, forming joint ventures across the island. A new emphasis was placed on private farming; farmers and cooperatives now sell their surplus at prices determined by supply and demand in 304 farmers markets. Socialist state enterprises are required to turn a profit. Small enterprise was permitted and now employs four percent of the labor force.

The most severe blow to Cuba may have been the loss of its socialist trading partners, which accounted for three fourths of Cuba's foreign trade. Cuba had been a planned economy not only at the domestic level, but internationally as well – socialist bloc countries planned their trading relationships and specialized their domestic production according to their common plan.



As a result, many of Cuba's factories found that they were operating according to production plans, equipment and raw material supply sources, and customer relationships that simply ceased to exist. The new requirement to trade in hard currency meant, for example, that Cuba could not buy spare parts for its fleet of Hungarian buses. In 1992, a massive citrus plantation that spans much of the highway between Havana and Santa Clara had just begun operation, its production destined for the entire Soviet bloc. Cuba attracted Israeli investors who formed a joint venture, downsized the operation, introduced new irrigation techniques, and now sell profitably to new customers in western Europe.

#### Growth of gross domestic product

1990.....	-2.9%
1991.....	-10.7
1992.....	-11.6
1993.....	-14.9
1994.....	0.7
1995.....	2.5
1996.....	7.8
1997.....	2.5
1998.....	1.2
1999.....	6.2
2000.....	5.6
2001.....	3.0

*Tables contain Cuban official data unless otherwise noted.*

For all its changes, Cuba's economy is far from prosperous today. Many families struggle to make ends meet. Centralized control still inhibits progress and limits the scope of entrepreneurial initiative at all levels. Cuba's well educated workforce is underemployed. The circulation of two currencies, the non-convertible peso and the U.S. dollar – symbolizes progress for some Cubans and inequality for others.

But if Cuba does expand its economic reforms, or if it turns in the future to a fully market-based economy, the changes achieved in Cuba's first post-Soviet decade will have served as a foundation for such future policies.

## Purchasing Power in Cuba

For a socialist economy, Cuba has an unusual degree of income and purchasing power inequality, a phenomenon caused by high wages earned in new economic sectors and lower wages in sectors not yet reformed.

The average Cuban monthly salary in 2001 was 249 pesos, about \$10. However, Cuban government surveys estimate that 62 percent of households receive some portion of their income in dollars from remittances, pay supplements in state enterprises or joint ventures, or private entrepreneurial activity.

The value of the peso, which reached 120 to the dollar in 1994, has been relatively stable since 1996, trading at about 20 to the dollar. After the post-September 11 tourism slump and the economic damage caused by Hurricane Michelle in November 2001, foreign exchange earnings fell and the

## THE SIX FIXES

The bulk of Cuba's recovery can be attributed to six measures that affect all sectors of the economy.

### I. Opening the Door to Remittances

In 1993 Cuba legalized the holding of foreign currency by its citizens, which had the effect of creating a large new source of foreign exchange: remittances from family members abroad.

By 1998, in a comprehensive report on the Cuban economy, the United Nations Economic Commission on Latin America estimated that Cuba was receiving \$800 million annually in remittances; an independent Cuban economist estimated in 2000 that remittances totaled \$1 billion annually. An official Cuban estimate pegged remittances at \$744 million in 1996.

Regardless of the total amount, Cuba has clearly joined the club of Caribbean basin economies where family remittances are an important element of the nation's foreign exchange earnings.

Unknown amounts of remittances are carried by relatives from abroad when they visit Cuba. Many Cuban Americans send them via Western Union, which has 78 offices across Cuba, and the Canadian company Tran\$Card creates individual accounts where donors overseas make deposits, and Cubans make withdrawals from automated teller machines.

In an economy where the average salary is about \$10, remittances raise the standard of living of millions of Cubans. For example, an elderly woman with an 80-peso monthly pension explains that she is able to shop at farmers markets only when she receives remittances from her son in Spain or her son-in-law in the United States. The benefits of remittances are not evenly distributed, because they only reach those Cubans who have relatives overseas who can afford to send them.

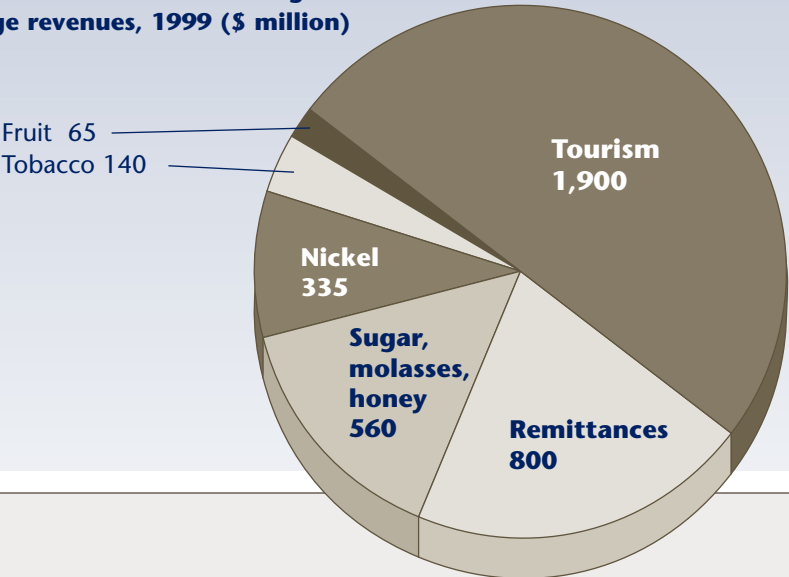
Remittances also have an impact on the broader economy. They represent significant revenue flows for small entrepreneurs, farmers markets, and the farmers and cooperatives who supply them. They also sustain the state's chain of retail "dollar stores," where appliances, food, clothing, and a large variety of household items are priced for sale in dollars. In turn, the profits from these dollar stores support loans and investments in state enterprises.

#### Remittances per capita, 1999 (in U.S. dollars)

Colombia .....	\$15
Cuba .....	\$73
Dominican Republic .....	\$203
El Salvador .....	\$255
Jamaica .....	\$289
Nicaragua .....	\$70

Source: Inter-American Development Bank

Selected sources of Cuban foreign exchange revenues, 1999 (\$ million)



peso’s value dropped to 26 to the dollar.

All Cubans receive a monthly allotment of basic foodstuffs such as rice, potatoes, cooking oil, and milk for children at heavily subsidized peso prices. However, this allotment only provides for part of the monthly diet. Cubans buy additional food with pesos at farmers markets, and they also need dollars to shop at *los shopping*, the state stores where many household necessities are priced in dollars.

To gauge purchasing power, consider a simple shopping trip where a Cuban buys groceries in pesos at a farmers market (one pound each of pork chops, rice, and black beans; two pounds of tomatoes; three limes; and one head of garlic) and household items in dollars (a bar of soap, a kilogram of detergent, and a tube of imported toothpaste). Together, these purchases cost 194 pesos. The chart below shows how much work is required of Cubans in various occupations to make these purchases. ■

Work time required for a 194-peso shopping trip

Entry-level preschool teacher .....	1.55 months
Retiree with pension .....	1.55 months
Cuban earning average national salary .....	15 days
Physician .....	8 days
Average entrepreneur .....	5 days
Nickel worker in joint venture.....	5 days
Farmers market meat vendor.....	3 days
Private tire repairman .....	2 days
Entertainer, Varadero hotel .....	2 days
Private taxi in Havana .....	1.5 days
Family with \$100/month remittances.....	1.5 days
Havana bed-and-breakfast entrepreneur.....	6 hours

*Calculations based on April 2002 prices in Havana farmers markets, exchange rate of 26 pesos to the dollar, and salary levels recorded by author during the past three years. Average entrepreneur earnings based on author’s survey of 152 entrepreneurs in 1998; all other salaries are based on interviews with individuals; they do not represent occupational averages. Market basket prices recorded by author.*

## II. Encouraging Foreign Investment

Foreign investment in Cuba is relatively small, and because of Cuba's legal and regulatory environment, U.S. economic sanctions, and other factors, in most areas Cuba is not a strong competitor for investment among Caribbean basin economies.

Foreign investors have formed 404 joint ventures with Cuban ministries and state enterprises, compared to 50 that operated in 1991. Half are concentrated in the basic industry, tourism, and construction sectors. Half come from three countries: Spain (97), Canada (75), and Italy (55). In 2000, their total sales were \$1.7 billion, of which \$758 million were exports.

Total investment is approximately \$4 billion since 1993. Despite the relatively small amount of capital invested – for comparison, in the 1990's two U.S. companies invested \$2 billion in Mexican telecommunications alone – investment in Cuba has a significant impact because it follows a three-decade investment drought.



*A soy processing plant, using Canadian investment, allows Cuba to produce its own oils and other soy products instead of importing them. On opposite page, Cuba's telephone system is being modernized with Italian and Mexican investments.*

A tourism industry with hotels, resorts, restaurants, retail shops, airports, and ancillary services has been built virtually from scratch. About 1.7 million tourists visited Cuba in 2000, six times the peak reached in the 1980's. Foreign investment has boosted mineral and energy production. It has also improved telecommunications by modernizing infrastructure and providing better customer service.

These investments have significant impacts on their Cuban workers and managers. They receive training from the foreign partner, whether in international business practices, customer service in hotels, or mining methods and safety. They also receive better pay

than Cubans who work for the state because in addition to their standard peso salary, many receive pay supplements, either in dollars or in kind. This is in spite of a steep labor tax that is paid by the joint ventures through the employment agencies that are technically the employers of the joint venture workers.

Here are examples drawn from interviews with workers across Cuba. A shift manager at a nickel plant in Moa operated by a Canadian-Cuban joint venture earns 460 pesos monthly plus a bonus paid in dollars that averages \$70 per month. (This compares to the average Cuban salary of 249 pesos per month.) A hotel cleaning woman in Varadero earns a 267-peso salary plus a \$4 supplement, plus \$10 that represents her share of pooled tips that are distributed to all workers. Nearby, the "Superclubs" resort pays a \$40 monthly supplement. At





the phone company ETECSA, a profit-sharing fund adds \$10 monthly to an operator's 200-peso salary, more than doubling her earnings.

Foreign investors bring important transfers of technology and knowledge. One example is the *Energas* joint venture between Cuban corporations and Canada's Sherritt Power Corporation, a project in which Sherritt had invested \$161 million as of December 2001. *Energas* has the capacity to generate 193 megawatts of electrical power using Cuban natural gas from the Varadero and Boca de Jaruco oil fields east of Havana. The gas, a by-product of Cuban oil extraction, was previously burned off, wasting a source of energy and chemicals and producing heavily sulfurous air pollution. The natural gas now produces seven percent of Cuba's electricity; it supplies all power to the Varadero beach resort area and delivers surplus electricity to the national grid. As the gas is processed, sulfur (more than 3,500 tons per year) and other chemicals are refined and sold for industrial uses.

In addition to joint ventures, Cuba uses "joint production agreements" to attract foreign capital, markets, and know-how. These are simpler, more flexible arrangements that avoid the long approval process required of joint ventures, and do not expose foreign partners to possible U.S. sanctions under the Helms-Burton law. In the Ministry of Light Industry, for example, 50 of the 125 enterprises have joint production agreements with foreign partners. In these agreements, the Cuban enterprise typically supplies the workforce and infrastructure, while the foreign partner supplies raw materials, technology, and training. There is no profit sharing as in joint ventures. Instead, partners agree on a target market and a price, then share revenues from products exported or sold within Cuba.

### Foreign investment results

#### Crude oil production (thousands of tons)

1990 .....	671
1995 .....	1,471
2000 .....	2,800

#### Natural gas production (millions of cubic meters)

1990 .....	33.7
1995 .....	17.3
2000 .....	660

#### Expansion of the basic phone network

	1994	2000	2004 (projected)
Lines in service (thousands)	.....350	.....482	.....1,064
Teledensity (lines per hundred inhabitants)	.....3.2	.....4.4	.....9.4

#### Nickel production

(thousands of metric tons)	
1989 .....	46.0
1993 .....	30.2
1996 .....	53.7
2001 .....	82.8

### III. Using Incentives to Revive Agriculture

The economic crisis of the early 1990's forced Cuba to make three important changes in agriculture policy.

First, Cuba redistributed about two-thirds of state lands to cooperatives and individual farmers.

Second, farms and cooperatives, regardless of size, type of organization, or ownership, were given material incentives to increase production. They are now permitted to sell their surplus on the open market once they have delivered their contracted quota to the state.

Third, farmers markets were opened in October 1994 to bring this surplus produce to consumers in a new, legal channel of food supply that complements the state's distribution system.

There are 304 farmers markets operating throughout Cuba, 49 in Havana alone. Three fourths of their produce comes from private farmers. At these markets, prices are high for Cubans earning pesos only (a pound of pork costs six percent of a doctor's monthly salary, about 15 percent of a retiree's pension), but they have plenty of customers, and they are competitive. Official figures show that ten percent of household expenditures are spent at farmers markets.

To reach Cubans of moderate and low income, the Cuban government allows cooperatives to sell directly to consumers once each month in cities, and it has

set up small produce stands called *placitas* throughout residential neighborhoods where state farms and cooperatives sell produce at reduced prices.

Cuba is also using urban agriculture to boost food supply and to improve the Cuban diet by increasing consumption of fresh vegetables. 2,611 small state enterprises, named *organopónicos* for their organic growing methods, have sprouted since 1995. Some are tucked in small vacant lots, while larger ones are found on the outskirts of Havana and other cities. They grow everything from spinach and other vegetables to fruits and herbs in raised beds of dark, organically enriched soil.

*Organopónicos* typically have 20 or fewer workers. These enterprises must repay state loans that were used



*Tobacco cultivation in Pinar del Rio province.*

*Produce sales at a Havana farmers market.*





*On the outskirts of the city of Santa Clara, an urban garden produces vegetables for sale.*

for their start-up investments. Still, many earn profits that enable them to pay bonuses to their workers; in Havana, a worker who earns a 250-peso monthly salary received a 630-pesos pay bonus during one recent month.

These measures have been successful, but Cuban data continue to show that the Cuban diet, while improved since 1992-1993, still falls short of recommended levels of some nutrients. The United Nations Food and Agriculture Organization places Cuba in a category of “moderately low” undernourishment.

#### **IV. Replacing Sugar with Tourism**

Sugar production has been a mainstay of the Cuban economy for centuries. For the first 30 years of Cuban socialism, sugar was swapped for Soviet oil at preferential prices.

In the past decade, however, without the artificially profitable Soviet trade, and with a worldwide supply glut depressing prices, the sugar sector in Cuba has come to resemble declining American industries such as textiles and steel. “There is no future in cane cut by hand,” President Fidel Castro says. Global competition poses an almost insurmountable challenge, but traditional employment patterns – sugar employs 478,000 Cubans, 15 percent of the nation’s workforce – makes the sector politically sensitive and its economic rationalization difficult to accomplish quickly.

Not even a resumption of U.S. trade would save the sector. As a Cuban analyst points out, Cuba exported 3.2 million tons of sugar to the United States in 1959,



*Local tourism revenues are dedicated to restoration of Old Havana's colonial-era buildings and public housing. Below, the Palacio de los Capitanes Generales, where Spanish governors resided.*



and today the United States imports fewer than 2 million tons from the entire world.

Billboards in the countryside extol the value of sugar production to Cuba's economy and culture, but in fact the sector has been forced to decline. The less efficient half of Cuba's sugar mills have closed.

The Cuban government is pursuing a strategy that features reduced sugar production, a search for greater efficiency, and attempts to diversify the products derived from sugar cane. These include organic sugar exported to Europe, high-grade industrial alcohols, raw materials for paper products, animal feeds, particle board for construction, and generation of electricity by burning the waste products from refined cane. A sugar ministry official says that ten percent of the sector's income now comes from sales of sugar derivatives. These are sound improvements, a Cuban analyst says, "but they can't be confused with returning sugar to its position as the central axis of the economy." Cuba's 3.5 million ton sugar harvest in 2001 was 44 percent of the 1990 harvest.

Low yields are a chronic problem in the sugar sector. Over 90 percent of sugar production is on Cuba's least efficient type of agricultural cooperative which was the result of the breakup of massive state farms in the early 1990's. Much of the sector also operates on short-term financing at high interest rates, which adds additional production cost.

As Cuban policymakers manage the difficulties of the sugar sector, they are placing strategic emphasis on the sector that offers greater comparative advantage in the global economy: tourism.

To attract visitors, Cuba is developing three types of destination: beach resorts, centers of colonial architecture, and more recently, eco-tourism. Hotel capacity tripled during the 1990's to the current level of 37,000 hotel rooms; Cuban officials say that 31 joint venture with foreign investors have contributed \$1.1 billion in capital to hotel development. Additionally, 50 hotels are managed by foreign companies under management contracts.

Tourist visits climbed from 340,000 in 1990 to nearly 1.8 million last year.

Tourism has broad impact on the rest of the Cuban economy. It is the top foreign exchange earner, generating more than half Cuba's foreign exchange earnings. It supports about 300,000 jobs in tourist sites – these are coveted jobs because the workers earn dollars – and in the industries that supply them. Large numbers of small entrepreneurs, especially private restaurateurs, artists,



*Sugar production in Villa Clara province.*

taxi drivers, and people who rent rooms in their homes, are sustained by tourism. Tourism earnings are funding the extensive restoration of historic buildings and monuments and public housing in Old Havana, the capital's zone of Spanish colonial architecture.

The tourism sector faces several challenges. Cuba has enjoyed success in attracting relatively low-cost package tours; to expand the number of high-spending visitors, investments are being made in golf courses, museums, marinas, restaurants, and other facilities that make Cuba a more complete destination.

Cuba is also working to substitute domestic production for imported supplies. In the early 1990's, tourism generated only limited net revenues because nearly all supplies for the industry, including fruits, furniture, and construction materials, were imported. Today, Cuban industries supply fresh food, beverages, furniture, towels, soap, and many other materials to the tourism sector. Officials say that tourism enterprises now make 67 percent of their purchases from Cuban suppliers.

Like other tourism destinations worldwide, Cuba is still gauging the impact of the September 2001 terrorist attacks. In the long term, however, it seems a safe bet that Cuba has considerable competitive advantages still to exploit in tourism. As the sector grows, it will generate additional employment and growth in the rest of the Cuban economy.

**Cuban sugar production**  
(millions of metric tons)

1990 .....	8.0
1991 .....	7.6
1992 .....	7.0
1993 .....	4.3
1994 .....	4.0
1995 .....	3.3
1996 .....	4.5
1997 .....	4.2
1998 .....	3.2
1999 .....	3.8
2000 .....	4.0
2001 .....	3.5

**Tourism growth**  
(thousands of visitors)

1990 .....	340
1991 .....	424
1992 .....	461
1993 .....	546
1994 .....	619
1995 .....	746
1996 .....	1,004
1997 .....	1,170
1998 .....	1,416
1999 .....	1,603
2000 .....	1,774
2001 .....	1,774

**Tourism gross revenue growth**  
(\$ million)

1990 .....	243
1991 .....	402
1992 .....	550
1993 .....	720
1994 .....	850
1995 .....	1,100
1996 .....	1,133
1997 .....	1,515
1998 .....	1,759
1999 .....	1,901
2000 .....	2,034
2001 .....	1,800

## V. Overhauling State Enterprises

Cuba's economic crisis also forced officials to work to improve the system of state enterprises that were built during 30 years of Soviet-style state planning.

The government replaced "material planning" – the centrally planned allocation of raw material inputs combined with requirements that enterprises deliver set quantities of goods – with financial planning, where profitability is required. Subsidies to state enterprises were reduced progressively. New financial institutions were set up to provide loans to state enterprises.

The state bureaucracy was reduced from 50 to 31 ministries in the early 1990's, and the remaining ministries were downsized by as much as two thirds. Foreign trade was decentralized as 350 enterprises were permitted to import and export on their own authority. Incentive pay systems were introduced, initially in enterprises that earn hard currency revenues, to reward worker productivity with salary bonuses. (73% of the workforce is under such incentive plans today.)

Cuba has also embarked on an ambitious formal reform of state enterprises, a process called *perfeccionamiento empresarial*. This process began in 1998 and is patterned after an overhaul of military enterprises that began in the 1980's.

Under this process, in theory, state enterprises will lose their subsidies entirely and be made to thrive by serving the internal and export markets.

The process begins when an enterprise is certified to have a full and accurate accounting of its finances. Next comes an exhaustive, self-critical evaluation

where workers and managers examine each area of the business and compile recommendations for a re-engineering of operations and payrolls to the fit the enterprise's new business plans. When the recommendations receive final approval, managers are given a degree of autonomy, including the ability to hire and fire workers without the involvement of ministries or other government organs. They are required to create pay plans that provide incentive payments to reward higher output. Of Cuba's 3,000





Government subsidies to state enterprises (millions of pesos)

1990 .....	2,987
1991 .....	3,882
1992 .....	4,162
1993 .....	5,434
1994 .....	3,447
1995 .....	1,803
1996 .....	1,624
1997 .....	1,350
1998 .....	1,139
1999 .....	770
2000 .....	460

state enterprises, 244 had completed this process as of June 2001, and 1,530 were in various stages of self-evaluation and re-engineering.

State enterprise reform is proceeding slowly because the self-evaluation and planning processes are so thorough and detailed, and also because the Cuban economy could not easily withstand the unemployment that would result if managers of inefficient enterprises were all at once required to reach profitability and permitted to lay off workers.

One company that has completed the *perfeccionamiento* process is the *Empresa de Goma Conrado Piña*, a rubber products company founded in 1945 in El Cotorro in Havana province. It produces sneakers, automotive hoses and gaskets, and tires for cars, trucks, and bicycles.

The company’s top executive, Lázaro González, says that in the past, his managerial authority was “very limited – practically all our problems were resolved at higher levels,” meaning in the Ministry of Basic Industries. His job “was really to carry out directives from above. I couldn’t structure my payroll or designate who works with me. The plan didn’t have to do with customers.”

“If I surpassed my targets they congratulated me,” he said, and “if I fell short they criticized me” – but in either case there was no financial impact on the company or on the earnings of its managers and employees.

The company employs nearly 1,700 workers, about the same number as before *perfeccionamiento*. González said the gains have been dramatic: average production increased 83%, sales increased 60%, after-tax profit is up 300%, and there is a 95% labor productivity increase. After-tax profits in 2000 were \$2.13 million, over triple the 1999 level. The enterprise pays tax of 25% of its payroll spending and 35% of gross profit.

These gains enabled the firm to increase its average monthly base pay by 74% to 390 pesos. Because the company has dollar revenues – it sells to foreign exchange earners such as the state’s chain of dollar stores and the Ministry of Sugar – it is able to pay dollar bonuses. Depending on monthly production, workers earn a 5-10% dollar bonus, so that a worker earning a 300-peso salary would receive \$15 (the equivalent of 390 additional pesos) if a 5% bonus is paid. Workers have automatic teller machine cards and receive their pay by direct deposit.

If *perfeccionamiento empresarial* succeeds across the Cuban economy, it will signal the end of the old state planning model. It will not be simple to achieve – many aspects of it go against the grain of the socialist concepts that Cuban workers and managers have known for four decades. But it bears watching because its implications are potentially far-reaching, and it is the one systemic change that Cuban economic officials are pushing today.

## VI. Allowing Small Enterprise

A first-time visitor to Havana in 1991 was struck by the lack of commercial bustle that distinguished its streetscapes from those of other major Latin American cities. Not even a flower vendor was in sight, and it seemed that commerce was conducted behind closed doors.

At that time, a very limited amount of entrepreneurship was permitted in Cuba; 10,000-15,000 people worked as tailors and hairdressers, and in a few other occupations. Otherwise, the state was the employer.

This changed in September 1993 when Cuba legalized self-employment in over 150 occupations to provide a new source of employment and a new supply of services in an economy hit hard by factory closings and layoffs. A new entrepreneurial sector soon came into being and peaked at 209,606 licensed entrepreneurs in January 1996.

To start a microenterprise, a Cuban must acquire a license from the local labor ministry office and register with tax authorities. Today about 153,000 Cubans, four percent of the workforce, are self-employed as licensed entrepreneurs. Several times this amount are estimated to work full-time or part-time without a license.

The sector faces significant restrictions.

Except for food service operations – streetside food stands or private restaurants – assistants or employees are not permitted. Private restaurants are limited to 12 seats and may not serve beef or shellfish. Private taxis are barred

from picking up passengers at tourist hotels or airports.

University graduates may not work on their own in their professional field; for examples, teachers may not work as private tutors. Supplies may not be purchased on the black market, and the state provides no source of supplies at wholesale prices. Inspectors enforce all these restrictions, often by requiring an entrepreneur to show receipts from state stores that account for his supplies.

The 27 percent reduction in the number of entrepreneurs from the 1996 peak has several causes.

Taxes on personal income from non-state employment were re-instituted in Cuba in 1996 for the





first time since the early 1960’s. Taxes are paid in advance in monthly installments and reconciled at year’s end with a schedule of progressive tax rates. The monthly advance payments are non-refundable. Marginal rates begin at five percent for annual incomes below 3,000 pesos and peak at 50 percent for incomes above 60,000 pesos.

Income taxes caused many entrepreneurs to give up their license; some continued to work without a license, while others sought other employment. Some work illegally in partnership, such as two tire repairmen in Central Havana who share one license and pay only half the taxes they would

pay if they operated in full compliance with the law.

Licensed entrepreneurs

1993 .....	10,000-15,000
April 1994 .....	151,130
June 1995 .....	170,000
January 1996 .....	209,606
September 1996 .....	184,922
January 1997 .....	167,197
March 1997 .....	171,861
April 1997 .....	180,916
August 1997 .....	176,183
April 1998 .....	165,438
May 2000 .....	159,229
April 2002 .....	153,300

Other entrepreneurs stopped operations because they were in competition with each other, or with the state. In Havana’s Vedado neighborhood, a woman closed her private restaurant because so many others operate nearby. Other restaurants closed due to competition with the state; since 1993 state restaurants and hotel restaurants have increased dramatically in number and quality.

Regulatory enforcement, at times arbitrary and at times accompanied by stiff fines, causes other closures. Regulations and enforcement seem to fall most heavily on taxis, restaurants, and others who compete with state enterprises. In Old Havana, for example, a popular outdoor artisans’ market is restricted to four days of operations per week so as not to compete with nearby state stores that sell crafts, paintings, and souvenirs. In 2002, new regulations were issued that have the effect of freezing at 8,600 the number of licenses granted for transportation of people in private cars.

Still, it is easy to find entrepreneurs who work within the law and make a good living. A retired couple in Havana rents rooms in their home for \$40 per night; they pay \$250 per room in tax per month, but they have a steady clientele and pocket about \$1,500 per month. In Villa Clara province, a tire repairman earns about 2,000 pesos per month. In Havana, a private taxi driver who earned 450 pesos per month as deputy director of a state construction enterprise now earns \$100-\$150 per month. The author surveyed 152 entrepreneurs in 1998 and found an average income, after taxes and business expenses, of 743 pesos, about three times the average state salary.





Officials have mixed views about Cuba's self-employed. "They can do some activities better than the state," economy minister Jose Luis Rodriguez says, "but we can't achieve development through small enterprise." Officials say their policy is neither to encourage nor discourage entrepreneurship. While there has been discussion of reduced regulations that would allow the sector to expand, it seems clear that no such policy changes are on the horizon, even though they would expand employment and family incomes.

## CUBA'S NEW ECONOMY AND THE CHALLENGES AHEAD

**H**ow has Cuba's economy changed?

As a matter of policy, Cuba has neither abandoned socialism nor proclaimed a systemic reform according to a Chinese, Vietnamese, or other model of revised socialism. The state retains a predominant guiding role in economic production.

However, the state exercises that role in a very changed context. "Fulfillment of the plan" may still be a watchword for workers and executives, but today's plans aim at hard-currency exports and profits. One measure of the change is the career of one man, Miguel Figueras, who served in the 1980's at the center of the socialist planning apparatus as senior vice president of the state's planning board. Today he works in the tourism ministry, overseeing an industry that makes extensive use of foreign capital and management experts. He studies data about demographics and market segments, looking for ways to make Cuba a destination that greater numbers of Canadians and Europeans will want to visit regularly.

Taken together, Cuba's reforms of the 1990's have had important results. Even under a burden of U.S. economic sanctions that intensified during the decade, they pulled the economy out of its dire crisis and restored growth while preserving essential health and education services.

## Black, White, and Gray in the Cuban Economy

Cuba's economic reality can be frustrating to assess because it is only partially explained by examining laws, regulations, and the enterprises that operate under them. It is equally important to observe the substantial economic activity that occurs every day, often in the open, on or outside the margins of the law.

Cuba's farmers markets are thriving outlets for freely priced sales of surplus produce. However, there is no legal provision for wholesale sales, or for the simple enterprise of farm-to-market transportation – yet every day, these activities take place. Truckers buy produce from farmers, transport it to cities and towns, and meet market vendors who gather before dawn to buy the produce they will sell at market that day. Naturally, the trucker/wholesalers earn a profit. Their activity is not legal, they make no effort to conceal it, everyone in Cuba is aware of it, and it is tolerated. Without it, the farmers markets would grind to a halt. Officials acknowledge this fact, and they say their main concern is to avoid “speculation” and excessive wholesale profit margins that would unduly inflate consumer prices.

Foreign investors who operate joint ventures pay their workforce through a Cuban employment agency. They may pay an agency \$450 per month for a worker, most of which is retained by the agency (to contribute to government social programs, officials say), leaving a worker with a salary of about \$15 paid in pesos. Some investors employ profit-sharing plans that legally augment workers' earnings. Sheritt International, a Canadian company, negotiated a provision in its nickel joint venture agreement that allows it to pay substantial dollar bonuses each month. The vast

majority of joint ventures (and many state enterprises) seem to provide workers a monthly basket of household necessities that would have to be bought at stores where all goods are priced in dollars. However, many joint ventures engage in a practice that has no legal basis at all – they simply make additional cash payments, in dollars, to their workers, often \$100 or more per month. For workers and their families, this makes a huge difference in an economy where the average state salary translates to about \$10.

Cuba's housing market provides another example. Cubans may legally trade housing, but they cannot pay cash as part of the transaction, even if parties trade housing units of clearly differing values. This policy is based on the idea that housing is a social good that should not be subject to market sales. In reality, there is an active market for all kinds of housing where cash is used to complete transactions of housing units of different value. Typically, more than two parties are involved; brokers arrange swaps involving small chains of buyers and sellers, where each swap in the chain has an accompanying cash payment. In Havana, brokers, buyers, and sellers gather Saturday mornings on the Paseo del Prado to try to arrange deals. The cash payments are routinely made, but reports of enforcement actions are scarce.

These are examples of activities that are not legal but are routinely tolerated – call them “gray market” activity.

In addition, there is a thriving black market where goods of all kinds are sold. Cheese and vegetables are sold alongside highways, and fruits and beef are sold door-to-door in Havana residential

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The reforms shifted production toward areas of greater comparative advantage and linked Cuba's educated workforce with more modern technology and know-how. Hundreds of thousands of managers, workers, farmers, and entrepreneurs are in jobs that did not exist a decade ago, gaining valuable experience in market settings. Their income is tied to their output, and they earn far more than average workers in the state sector. Accounting, productivity, cost control, and customer service are once again important.

Yet Cuba's recovery is far from complete.

After eight years of growth, Cuba's gross domestic product of approximately \$20 billion is only now returning to its pre-crisis level.

While new, high-paying jobs have been created, they have not been created rapidly enough to satisfy the demands of the labor force. Cubans who have a normal state salary, no dollar income, and no family remittances are at a serious disadvantage acquiring food and household necessities in a half-peso, half-dollar economy.

Extreme inequality of income, and the inequality of opportunity to obtain high earnings, has a distorting effect on the labor market.

One distortion occurs when professionals work outside their profession and below their qualification level to increase their earnings. In Cuba one finds engineers operating restaurants, psychiatrists working as car rental agents, and doctors moonlighting in taxis.

These decisions are rational from a family breadwinner's perspective because they all increase earnings. But they diminish the value of Cuba's investment in high-level professional training. In the words of a Havana taxi driver, "I would prefer to exercise my profession, but there came a time when I could either continue in the work I like, or my family could eat." So the former petroleum technician drives a cab.

A second distortion affects the younger generation. Many decline to work for a normal peso salary and are effectively outside the labor force; a 26-year-old Matanzas man says that rather than work for a normal state salary, he prefers to work on his own as a catch-as-catch-can entrepreneur. From time to time he rents a room in his house, sells goods on the black market, and looks for new business opportunities.

According to an analysis based on Cuban data by Claes Brudenius of the Center for Development Research in Copenhagen, Cuban university enrollment declined 58 percent between 1990 and 1999. This accompanies a dramatic increase in the percentage of men in the 20-29 age group who do not enter the labor force. Both are signs that some Cubans perceive informal employment, tourism jobs, or other sources of dollar income as more promising than higher education as routes to economic advancement.



neighborhoods, outside of the legal framework. Others goods, such as construction materials and fuel, are purloined from the state and sold privately.

Services are also supplied illegally. Many Cubans work occasionally as tutors, repairmen, or taxi drivers but do not obtain a license or pay taxes. These occasional entrepreneurs vastly outnumber their licensed, full-time counterparts.

Black market activity is not unique to Cuba, although it is more extensive than in other Latin American countries because of the rigidities of socialism.

The state may tolerate some "gray market" activity because it is relatively benign and because, as in the case of

farmers market wholesalers, it performs a vital function. In some cases, the legal framework eventually changes to accommodate the gray-market private sector. For example, *paladares*, Cuba's famous private family restaurants, existed for years in an undefined legal area before the government made them legal in 1993.

For Cuban citizens deciding how to earn their living, it is therefore necessary to examine not only what is legal and what is illegal, but also to know what kinds of activity may be generally allowed even though they are outside the law. As a result, millions of Cubans accept a degree of uncertainty in their daily work, and are exposed to the possibility that they could face legal penalties. ■

One can envision additional economic reforms that would help to correct these distorted incentives and also promote growth and job creation. For years, Cuban academic journals and even Communist Party documents have discussed policy changes that would build on current reforms to stimulate agriculture, small enterprise, and other sectors. Cuban economic officials, however, say their task today is to continue "consolidating" the economic reforms of the early 1990's by encouraging new investment, promoting exports, and pressing for greater efficiency throughout the economy.

Based on the current economic policy discussions in Cuba, it seems highly unlikely that a new round of economic reforms would be adopted in the near term. It therefore seems very likely that the partially met challenges of Cuba's unique brand of socialism will be faced by the island's next generation of economic policy makers. ★



To contact the author:  
[peters@dgs.net](mailto:peters@dgs.net)

Photos by Philip Peters

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## FURTHER READING

*The Cuban Way: Capitalism, Communism and Confrontation*, by Ana Julia Jatar-Hausmann, Kumarian Press, 1999.

An ample listing of Cuban websites with Cuban media, speeches, announcements, decrees, other official information, and news on Cuba's economy, is found at [www.cubaweb.cu](http://www.cubaweb.cu).

The Georgetown University Cuba Briefing Paper Series covers economic, social, and political topics in depth. Papers are found at: [www.georgetown.edu/sfs/programs/clas/Caribe/cbps.htm](http://www.georgetown.edu/sfs/programs/clas/Caribe/cbps.htm).

Lexington Institute studies on Cuba's economy (state enterprise reform, telecommunications/information technology, farmers markets, Old Havana restoration), U.S.-Cuba relations, and other materials are found at [www.lexingtoninstitute.org/cuba](http://www.lexingtoninstitute.org/cuba).

*Havana: Two Faces of the Antillean Metropolis*, by Roberto Segre, Mario Coyula, and Joseph L. Scarpaci, John Wiley and Sons, 1997.

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"Cuba's Economic Performance and the Challenges Ahead," monograph by Archibald R.M. Ritter, Canadian Foundation for the Americas; see [www.focal.ca](http://www.focal.ca).





