



by Philip Peters
Lexington Institute
September 2006

CUBA'S SMALL ENTREPRENEURS:
Down But Not Out

CUBA'S SMALL ENTREPRENEURS:

Down But Not Out

by Philip Peters
Vice President,
Lexington Institute
September 2006

School's out in Havana, and Ricardo, a mechanic who quit his government job, gets busy in his driveway making milkshakes and money. Students in uniform line up as he spoons mango slices, powdered milk, ice, water, and sugar into his blender, then serves the shakes and an occasional pizza. He hustles, knowing that for all the decisions Cuba's government makes about the economy, his earnings depend on him alone.

Ricardo engages in *trabajo por cuenta propia* (self-employment), the Cuban version of small enterprise that was legalized in 1993. Then, the advent of legal entrepreneurship seemed to point to policies that would add more market mechanisms to the economy's socialist structure.

This was not to be. Self-employment was one of several measures that helped Cuba end the economic emergency brought on by the loss of Soviet bloc support in the early 1990's. It was deemed to be less necessary when Cuba's economy recovered, and was scaled back along with some of the other market-based reforms adopted during the height of the emergency.

While these entrepreneurs, called *cuentapropistas*, are reduced in number, they remain visible in towns and cities from one tip of the island to the other; a distinct, private sector of the economy that occupies about three percent of the Cuban labor force.

These entrepreneurs are not a major factor in Cuba's economic output. But their sector is significant as an alternative to state employment where Cubans exercise initiative and considerable ingenuity to provide goods and services to Cubans and tourists alike. Even as they operate under policies that reflect the state's discomfort with the concept of private enterprise, they pay taxes and earn higher-than-average incomes in an economy that has rebounded but not yet restored standards of living that Cubans knew in the 1980's. For Cuba's future, this entrepreneurial sector is significant as a potential starting point for new policies, if Cuba's government were to decide once again to use market mechanisms to generate jobs and growth.

Reforms born of need, not conviction

The small entrepreneurs who are visible across socialist Cuba today—retirees renting rooms in their homes to tourists in the spectacular scenery of Pinar del Rio province, artists, handymen, seamstresses, and cab drivers in Havana, home-based restaurateurs in sun-baked Guantanamo—are one result of an economic emergency that the Cuban government faced more than a decade ago. Today their fortunes are affected by the government's perception that it weathered that crisis and has now revived the economy.

When the Soviet bloc dissolved, Cuba was deprived of a subsidy that by some estimates amounted to one fourth of gross domestic product, and was cut off from the myriad commercial relationships that accounted for three fourths of its foreign trade. The division of labor between the members of the socialist economic bloc, the subject of negotiated five-year plans, became irrelevant. Cuba's domestic economic planning, which was built around that division of labor, became unworkable. By 1993, gross domestic product had fallen by more than one third, factories were idled and workers laid off, inflation was ravaging the peso, agriculture plunged into crisis, fuel was scarce, and Cuba's economy came as close to collapse as could be imagined.

In response, the Cuban government kept its commitment to socialism but engaged in a tactical retreat from the orthodoxy of state planning.

With shortages of fuel, machinery and spare parts plaguing large-scale agriculture, Cuba turned to smaller-scale, incentive-based farm production. Large state farms were divided into smaller cooperatives, land was distributed to new individual producers, and state farms, cooperatives, and

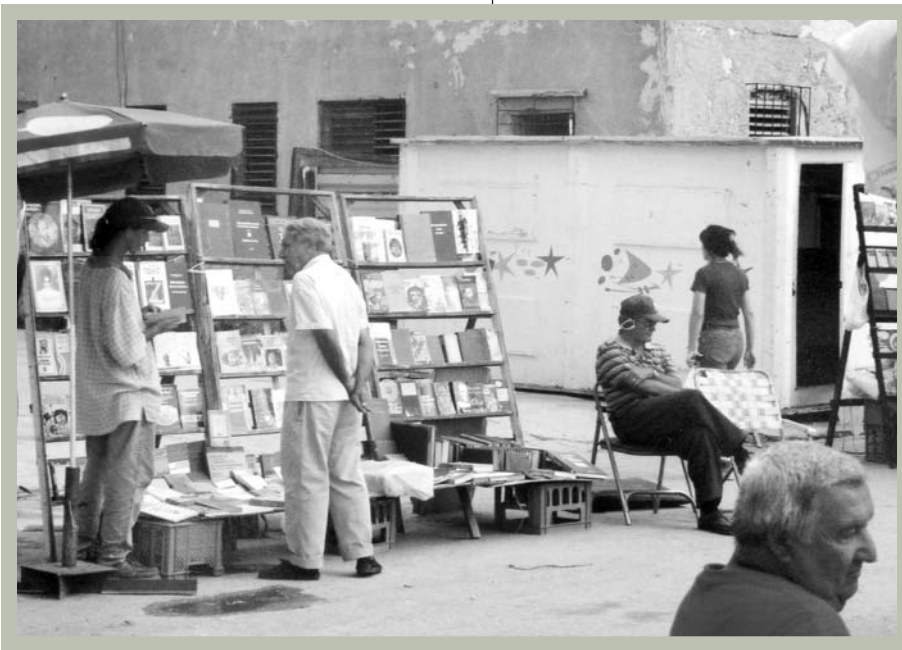
Cuban currency

Two currencies circulate in Cuba. The peso is used for state sector salaries, farmers market transactions, and many other transactions. The convertible peso is used by Cubans shopping in hard currency stores, by tourists, in joint ventures, and in many state enterprises. Some *cuentapropistas'* businesses operate in pesos, others in convertible pesos. The peso is valued at 0.04 convertible pesos, and the convertible peso, which until recently traded at par with the U.S. dollar, is worth \$1.08. For purposes of this paper, the term "dollar" is used instead of "convertible peso."

fold, and nickel output nearly doubled. Slowly but steadily, neighborhood by neighborhood, Cuba's museum-piece telephone network is being modernized. Farmers markets and small organic farm cooperatives emerged as a new, reliable source of food, although at market-determined prices far higher than those Cubans see when they take their ration books to state food distribution centers.

With these changes, socialist Cuba became a place less averse to experiments with market mechanisms. There was a widespread expectation that additional reforms would spur more growth by further lightening the state's hand in economic direction, decentralizing economic decisionmaking, and even allowing a level of economic competition.

However, the "reanimation" of Cuba's economy, as officials call it, led not to more reform, but to a sense in official circles that Cuba could afford to rely less on the market-based mechanisms that, however successful, were fundamentally a departure from the prevailing governing philosophy. The ideological flexibility that allowed communists in China and Vietnam to countenance ever-larger doses of capitalism was not to be found in the Central Committee of the Communist Party of Cuba. Cuba turned instead to new, lucrative economic relationships with Venezuela, China, and others to produce trade, credits, cut-rate energy supplies, investment, and other benefits.



Havana booksellers offer current and old books in several languages, and occasionally sell newspapers and magazines from the revolution's first years and from earlier periods.

Home rentals

Along the main street of Vinales, a small town that is a major tourism center in western Cuba's spectacular tobacco country, 33 of the 107 houses display signs that show they are licensed to lodge foreign visitors. Locals say there are about 300 private home rentals; if accurate, the private rentals outnumber the 173 rooms in the area's three state-owned hotels.

On the other end of the island in the historic town of Baracoa, private rentals are available throughout the town. A long-time employee of the town's only hotel says that they outnumber the hotel's 34 rooms. The renters' prosperity has led to many renovations, he said, leading some to call their sector "Little Miami."

In Ciego de Avila, a provincial capital that is not a tourism hot spot, a *cuentapropista* who rents a room to tourists says he is one of 43 with a housing rental license. He obtained his license in 2004, with difficulty. Tired of tussling with inspectors in his former pizza business, he decided to switch to a different line of self-employment. He prodded local housing officials for more than two years for a license to rent his spare room with a private bath and old Russian air conditioner. The main point of contention was the need to demonstrate that his family would not be overcrowded in its remaining space. He understands the Economics 101 concept of "elasticity of demand;" he charges the low rate of \$15-\$25 per night that reduces nightly profit and sometimes makes it hard to pay his monthly tax, but he attracts more first-time customers.

A 2005 academic study of Cuba's tourism industry noted that in addition to Cuba's 41,000-room hotel capacity, there are 5,000 to 6,000 rooms available for tourists to rent in private homes.

Our survey included twelve home rentals. On average, they had been in business three years and nine months and their average profit was \$438 per month after paying an average tax of \$267. The lowest tax per room rented was \$100 in Ciego de Avila, the highest \$250 in Havana's Miramar neighborhood.

Housing rental is a lucrative but challenging line of self-employment, made more difficult by taxes and regulatory requirements that have grown steeper in recent years. A 2003 law increased taxes by levying tax on common areas used by guests such as hallways, living and dining rooms, and patios, in addition to the per-room tax. A special license is required to offer food service to guests. Proprietors are required to keep a log of guests, their dates of stay, and their passport information, and they must keep records of their revenues.



Cubans who are licensed to rent rooms in their homes display a roof-shaped symbol to catch the eye of potential clients.

The main challenge that these *cuentapropistas* cite is drumming up business, because they must make their monthly tax payment even if their revenues are zero. Many advertise on the internet, using sites developed and hosted by friends overseas. Many also collaborate in informal referral networks and, following what one calls "the unwritten law of home rental," they pay commissions to people outside those networks who bring them clients.

A woman who has rented two rooms in Havana since 1997 struggled to establish her business. "At first, no one knew me," she said. She strived to achieve good quality and thereby establish a good word-of-mouth reputation. Her first big break was to rent to a group of Americans who generated lots of referrals and return business. But "the best thing that ever happened" was when her home was listed in the *Lonely Planet* tourism guide—a bit of free publicity that now generates steady business.

How many *cuentapropistas*?

September 1993	10,000-15,000
April 1994	151,130
June 1995	170,000
January 1996	209,606
September 1996	184,922
August 1997	176,183
December 1999	156,600
May 2000	159,229
December 2001	152,300
December 2002	152,900
December 2003	151,000
January 2004	149,000

These are Cuban government figures obtained from press reports, officials' statements, and interviews. While there is no independent source of data on this sector, and no place where detailed official figures are published regularly, the trends in the data above match what has been observable since self-employment started: growth after the 1993 decree followed by decline when an income tax was imposed and later when regulatory enforcement was stepped up.

Cuba's latest statistical yearbook states that there were 166,700 licensed *cuentapropistas* working in December 2004 and 169,400 in December 2005, 40 percent of whom are women. These figures, unlike those above, include vendors in Cuba's approximately 300 farmers markets, and musicians and writers licensed by the culture ministry.

Policy retrenchment

The reforms have not been abandoned, but since 2003 a policy retrenchment has reduced their scope and impact. Hundreds of state enterprises that had gained autonomy in making foreign exchange and import-export decisions found themselves once again governed by ministry officials in these basic business operations. Cuban authorities also quietly squeezed the foreign investment sector, and more than one hundred mainly smaller joint ventures have shut their doors.

The changes in Cuba's economy and economic policy also affected *trabajo por cuenta propia*.

In the early years, Cuban official statements readily described the benefits of self-employment, as in a May 1996 statement from the labor and finance ministries:

“...in the country's current economic conditions, [self-employment] complements state activity in the supply of goods and services to the public; for those engaged in it, it represents a way to increase personal income; it contributes to government revenues through tax payments; and it is one more option for employment.”

In 1997, the economic policy resolution adopted by Cuba's Communist Party Congress noted that self-employment would be maintained and the prohibition of partnerships among *cuentapropistas* might be eased. This idea fell by the wayside, as did an incipient debate that was then considering possible development of a small and medium enterprise sector.

Cuban officials later shifted to more neutral terms to describe self-employment. Economy minister Jose Luis Rodriguez said in February 2001, “We don't see that our country's development rests on self-employment or small private property holders.” In March 2001 he said, “We believe there is no reason for the self-employed sector not to exist if it follows certain regulations, but we don't stimulate it because we don't think it is the solution to our economic problems.” This attitude resulted in regulatory measures that squeezed this sector, as will be discussed below.

Former government economist Oscar Espinosa Chepe summed up this evolution in 2003, writing that while official documents said that self-employment would “help the economic revival,” the idea of independent workers and enterprises was so alien to the government's philosophy that officials allowed them “against their wishes” and only “with clenched teeth.”

Regulatory framework

Even though Cuba's socialist government nationalized industries and closed nearly all small enterprises in its early years, small numbers of Cubans still earned their living through self-employment. By the early 1990's, 10,000 to 15,000 Cubans were legally self-employed as barbers, repairmen, and other home-based providers of services.

The issuance of Decree-Law 141 on September 8, 1993 expanded self-employment dramatically, allowing it in 117 new occupations. By early 1996, 158 occupations were permitted and the sector reached its peak of 209,000 licensed workers that year.

In a Cuban study of Havana's economy that cited 2001 data on the city's 32,893 *cuentapropistas*, 56 percent were self-employed because they had been laid off from state jobs and declined offers of other government employment, 31 percent were retirees, and 13 percent were self-employed either as a first job or after deciding to leave state employment to work on their own. Fourteen percent worked in transportation services, 11 percent in housing rental.

A would-be entrepreneur must obtain a license from the local office of the labor ministry and then register with the tax agency to pay income tax. Municipalities have discretion to regulate licensing; for example, they may decide not to grant licenses for tire repair to limit competition with state businesses that provide the same service.

On October 1, 2004, as part of the general retrenchment in economic policy, the Ministry of Labor and Social Security issued new regulations governing self-employment.

The regulations are preceded by a statement that "self-employment, in the current economic revival that our country is experiencing, acts as a complement to some state activity in the production of goods and the supply of services of value to the public, and is an alternative source of employment..." However, it continues, some private economic activities might "be assimilated...by the central state administration."

The regulations provide that no new licenses will be granted in 40 categories of self-employment, but those working in those categories may continue to work and have their licenses renewed. But in all categories of self-employment, an "annual analysis" by municipal authorities will determine whether any licenses at all are necessary. That analysis is to focus on the local "situation of employment and the supply of services to the public."

The result is a reduction from 158 to 118 in the categories of self-employment where the government will, at its discretion, continue to grant new licenses.



Two men working for a state enterprise make churros at their stand near the farmers market in Ciego de Avila, and a sandwich vendor operates in the central square of Santa Maria del Rosario. In the 1990's, most operations such as these were operated by self-employed Cubans, but as the Cuban government decided to expand its food service operations, it has displaced private operators.

Taxes

Cuentapropistas paid no tax through the end of 1995. Then in 1996, Cuba reinstated the personal income tax, a simple progressive tax system that relies on taxpayer honesty to report income correctly. It applies mainly to *cuentapropistas*, but also covers artists who earn royalties and other non-state incomes. The National Tax Administration Office (ONAT) was created in June 1995.

Government officials say the income tax is needed to generate revenue, reduce income inequality, and compensate for the fact that entrepreneurs' housing, utilities, and other services are subsidized by the state.

Cuban President Fidel Castro addressed the income issue in 1995 before a meeting of provincial officials:

"We're not going to go back on what we have done, but we have to think about how to avoid creating a new rich class... It's good the competition this has brought, it's good that these markets and self-employment have taught people a little bit of capitalism...But we have to think of how to do things correctly...Some [of these self-employed] earn more in a day than our honored teachers earn in a month."

The income tax has these main features:

- Tax rates and monthly minimum tax payments (*cuota fija mínima*) for each occupation are set by the Ministry of Finance. For example, a manicurist pays 100 pesos, a bookseller in Havana's *Plaza de Armas* \$97.
- Taxpayers are required to submit year-end income statements (*declaraciones juradas*) by March 1.
- The monthly payments count as credit against a taxpayer's year-end tax payment, which is calculated by applying progressive tax rates to total income. Ten percent of income is deducted for expenses; this deduction is not itemized, and it is the same for all occupations, regardless of actual expenses.
- If the monthly payments exceed what is owed at year's end, there is no refund.
- Municipal governments may change the monthly payment for individual occupations, but they cannot reduce it below the nationally prescribed level. One municipal tax official explained that this discretion allows municipalities to "find a balance between supply and demand," i.e. to raise taxes in occupations it wishes to discourage.

In the case of each eliminated category of self-employment, the regulations identify the ministry whose enterprises will provide the good or service previously supplied privately. The regulations stop the issuance of new licenses in the food service business: family restaurants (*paladares*), small cafeterias, and streetside stands where pizza, sandwiches, coffee, and other items are sold. At the same time, the government has decided to expand its own retail food services.

Also eliminated from the possibility of acquiring new licenses were sellers of used books, masseurs, computer programmers, sports instructors, blacksmiths, welders, and others.



A flower salesman and his grandson make their way through the streets of Old Havana.

The regulations also provide that:

- *Cuentapropistas'* prices are fixed freely between seller and buyer.
- Only with local government permission can one work outside one's municipality, and then only within one's own province.
- Licenses have a two-year duration.
- When there are more applicants for licenses than a municipality is willing to grant, priority goes to the law-abiding, elderly, and disabled, and to low-income families.
- University graduates may be self-employed with special permission only, and never in their own field; i.e. a French teacher may not teach French at night as a private tutor.
- All *cuentapropistas* must maintain receipts that document the origin of all their supplies.
- *Cuentapropistas* may not do business with joint ventures involving foreign investors, and the only business they may do with state enterprises is to provide transportation services to the food and agriculture sector.
- License fees and monthly tax payments for self-employment may be suspended, if the state approves, in cases of military or agricultural mobilization, sickness, or a need to attend to a sick family member.

Entrepreneurial experiences

The experiences of Cuba's small entrepreneurs have several common characteristics.

Taxes and regulations have reduced the sector in a targeted way.

Cuban officials argue that the ranks of the self-employed have thinned "in a natural way" due to taxation and competition. That is demonstrably true, but government actions have also targeted specific occupations where the state has decided it wants less competition.

Many examples are found in the food service sector. The 2004 decision to stop granting new licenses guarantees that attrition will cut the sector's size over time. But the government has also used taxes, inspections, and other methods to add pressure.

A woman who makes ice cream in her Havana home and sells it from her front door noted in 2004 that inspections were becoming more frequent,

and a state food enterprise was getting into the habit of parking its ice cream truck directly in front of her house.

Another example is the Rodriguez family’s food stand that operated for eight years in the *Centro Habana* neighborhood. The business paid 1,800 pesos in taxes and earned after-tax profit of 3,500 pesos each month by selling roasted pork sandwiches for 10 pesos and fruit shakes for 3 pesos.

The food stand was first established at the “Precios Fijos” open-air market. When that market was closed, it moved to a local farmers market, then to another neighborhood where it won a clientele among local office workers. Municipal authorities then ordered the stand to close until a new location could be found, and a government enterprise established its own business at the location. “We did not abandon the work,” said the proprietor, formerly manager of a state cafeteria, “but where the state has a food stand, they won’t allow a *cuentapropista* to be there to compete...they copied everything from us—our roast pork sandwiches, our shakes, our fritters.” When interviewed in 2005, she had been waiting two months for a new location, and she did not know if the family would be able to restart the business. “We work with love because it is ours, the people who work for the state are there for eight hours and then they are dying to leave.”

Others had similar experiences. *Bicitaxis*, the three-wheeled vehicles that carry two passengers and offer limited competition to state taxis mainly in the Old Havana neighborhood, began to feel the pressure in 2001 when the zone most frequented by tourists was put off limits to them. One driver who usually earned \$30 per month after paying \$52 in tax, said then that he believed the *bicitaxis* would all be forced out of business. That did not occur, but they were restricted to carrying Cubans only and charging in

Earnings survey

	Peso businesses	Dollar businesses
Years in business	Six years	Five years, eleven months
Monthly tax	691 pesos	\$162
Monthly profit after tax	1,326 pesos	\$304
Tax as percent of revenue	34%	35%

These data are based on interviews with 73 licensed, taxpaying *cuentapropistas* conducted since 2003, evenly divided between those who do business in dollars and pesos.

Dollar businesses include taxi drivers, painters, artists, booksellers, home restaurants, and home rentals. Peso businesses include carpenters and similar services, coffee and lunch stands, tutors, messengers, locksmiths, tire, watch and shoe repair, and many others.

Asked to name their most important challenge, 32 percent cited the cost of supplies, 32 percent sales difficulties (soft or cyclical demand, hard-to-please customers), 30 percent regulation and taxes, and six percent working conditions and production difficulties.

The peso businesses’ average after-tax profit of 1,326 pesos is more than triple the average state salary of 398 pesos.

While we believe that our interviewees responded in good faith, their income figures may not be precise. Almost none keep track of profit and income on a monthly basis, and they made quick estimates to respond to our questions. Given that Cuban taxation relies partially on an honor system, and some taxpayers understate the income they declare to the state, they may have answered our question with the figures they provide to the state.



An idle bicitaxi.

pesos, police often moved them away from main avenues, and there were more frequent inspections and document checks. As a group, the drivers held meetings with municipal officials to address these issues in 2003, but to no avail. Independent journalists reported similar occurrences in other cities.

Some cuentapropistas have little to no difficulty with the state.

A bookseller in the city of Sancti Spiritus worked 20 years in a warehouse and earns 900 pesos per month in his home-based business. Inspections are “superficial,” he says, serving mainly to ensure that there are no pre-20th century books among his Spanish, English, and Russian titles.

An evangelical Christian who has a tire repair business in his garage outside Santa Clara earns about 2,000 pesos profit. Unlike many other *cuentapropistas*, he obtains his supplies easily and at fair prices in state stores. “I can’t make the business grow,” he says, “but I’m much better off than someone with a salary of 200 pesos per month.”

A woman who performs manicures and pedicures in her home in Havana since 1963 pays 100 pesos per month in tax and earns about 600 pesos in profit. She has no complaints about obtaining supplies, and in the course of an afternoon talking about her human rights activism while she attended to her customers, it was clear that she has a steady clientele.

A hairdresser in Old Havana dislikes having to pay hard currency for her supplies, but she obtains them easily and passes the expense on to her customers. Her average monthly profit is about 550 pesos.

A former central bank economist who sells books in Havana’s *Plaza de Armas* earns about \$400 per month. His biggest challenge is finding good books at a good price that will sell. “Investment is the only thing that can’t be planned in this business,” he said. “If I see a good book that I know will sell, I have to buy it.” To him, the reason for his sector’s ups and downs is simple; self-employment “started when there was a certain economic opening to increase people’s income and to create jobs, but it collides with socialist philosophy so there has been a contraction.”

In rare cases, there is state support.

In Havana’s small Chinatown, the city government has adapted the rules governing self-employment to encourage locals to operate a row of small restaurants. The restaurant workers earn a salary, tips, and a share of the restaurant’s receipts. One waiter earns 30 pesos per day, plus a share of pooled tips, plus a share of five percent of the day’s receipts.



An open-air market in Havana.

In Old Havana, the local government organized ladies who sew and embroider into a guild to keep their craft alive and to pass it on. It gave them a shop where they sell their products, and they received European aid for sewing machines that they use to teach local girls each weekend.

A retired merchant marine captain in *Centro Habana* cleared a vacant lot of construction debris, asked local authorities for permission to use it as a bicycle and motorcycle parking lot, and received it. He earns 550 pesos per month for himself and pays aides 20 pesos per day.

Many retirees depend on self-employment.

With many Cubans earning pensions in the range of 150-250 pesos per month, retirees frequently engage in entrepreneurial activity to supplement their income. Therefore one finds a retired lieutenant colonel of the Cuban armed forces earning about 800 pesos per month driving a taxi, and a retired physician in Havana working three hours daily driving a taxi to earn about 450 pesos per month.

“When I was young I thought that when I retired I would not have to work anymore, but I do,” says a 70-year-old retiree who operates a coffee and snack stand in southern Havana. Each month he earns a 150-peso pension and about 1,000 additional pesos from his business.

Many cuentapropistas are working below their qualifications.

Cuba’s labor market is distorted by the fact that the economy is split into two sectors. Those who work in areas affected by economic reform—joint ventures, small farmers, tourism, self-employment—can earn higher incomes, often in hard currency, while equally hard-working Cubans employed by the state earn peso salaries that may not meet their needs. The result is that among the self-employed, one finds highly trained individuals working in jobs that make no use of the investment that they and the government made in their own education. A former psychology professor operates a small restaurant, engineers are found selling books and driving taxis, a former teacher repairs shoes, and a marine biologist grows flowers on his land east of Havana and sells them in the city every day. Similar examples abound in the tourism sector.

Tourism provides the revenues for a significant part of the sector.

Cuban tourism executives are not alone in worrying about the ups and downs of tourist arrivals. Cubans who rent rooms in their homes—and the maids, cooks, repairmen, gardeners, night watchmen, and others that they hire—earn their living from tourism revenues. Also in that category are family restaurant owners and their employees, taxi drivers, artists, and vendors in open-air markets that serve tourists.

A wholesale supply system would solve problems that draw complaints both from entrepreneurs and the authorities.

Cuban officials crack down on the pilferage of materials from state enterprises that are used privately, sold on the black market, or end up as supplies for the self-employed. *Cuentapropistas* wish that they could buy their supplies at reduced prices in wholesale markets, but the state's ambivalence toward small enterprise seems to make that impossible. Nonetheless, such an innovation would likely reduce pilferage, and it would reduce the chronic problem that entrepreneurs have in obtaining supplies at prices that maintain their profit margins.

Purchasing power

To illustrate the purchasing power of Cubans of varied earnings, the following table shows how much work time is required to pay for a shopping trip for food at farmers markets using pesos (one pound each of tomatoes, pork chops, rice, and black beans, plus a lime and a head of garlic), plus a few purchases in dollar stores: a tube of Pepsodent toothpaste, a pound of detergent, a pair of Chinese pliers, and a liter of soy oil. The cost, with the dollar purchases converted to pesos, adds up to 248 pesos. The disparity in purchasing power among different lines of work explains why many engage in moonlighting, small-scale pilfering of state resources, or other black-market activity.

Retiree earning minimum pension	1.6 months
Day care worker earning minimum salary	1.1 months
Professor	3 weeks
State worker with average salary	2 weeks, 3 days
<i>Cuentapropista</i> hairdresser	2 weeks
Physician	1 week, 4 days
Varadero hotel housekeeper	5 days
<i>Cuentapropista</i> streetside snack vendor	5 days
Meat vendor in farmers market	4.5 days
Average <i>cuentapropista</i> (pesos)	4.1 days
Unlicensed bicitaxi	3 days
Hotel entertainer	2.8 days
<i>Cuentapropista</i> tire repair	2.7 days
<i>Cuentapropista</i> home rental (provincial)	7 hours
Average <i>cuentapropista</i> (dollars)	6 hours

Calculations based on salaries and prices observed in Havana, Santiago, Ciego de Avila, and Holguin. Farmers market prices were nine percent higher in Havana than in the provinces.

The “informal sector”

Cuba’s *cuentapropistas* are sometimes called an “informal” sector, but that term does not fit because they are licensed, pay taxes, and generally operate within the law. However, Cuba does have a large amount of entrepreneurial activity that takes place off the books, or “*por la izquierda*” (“off to the left”). Examples:

- On an elevator in a Havana apartment building, a girl with a backpack asks her fellow passengers, “Strawberries?” She had several more pints to sell before returning to Artemisa, her home town, with her earnings.
- A foreign resident of Havana contracted with a carpenter to have a home renovation job done; he appeared with an entire crew of tradesmen, as if they worked for a single enterprise.
- A visitor renting a room in a Havana home saw a woman walking down the street one morning with the shirts he had given his landlady to clean. The job had been handed over to the woman, who runs her own private laundry service.
- Sitting on a porch in a quiet western Havana neighborhood, two men are interrupted by a passing vendor offering cheese, then by another offering beef.
- People hailing taxis on Havana streets are often greeted by a private car that pulls over and offers a ride for a fee that approximates a licensed taxi’s fare.
- One afternoon on a traffic island by Havana’s Melia Cohiba hotel, a woman steps into the center of a group of trees and unpacks bags of clothing to display for a potential customer.
- Travelers arriving in provincial capitals are greeted by hustlers offering to show the way to private homes where, if the traveler rents a room, a commission is earned.
- A Havana home that rents rooms to foreign visitors employs two maids and a night watchman, all of whom serve both the family and the visitors by providing food, laundry, cleaning, and security services.
- An artist who sells to tourists at an open-air market near Havana’s cathedral needs help because sales are brisk and he needs time to create. He pays four men to make sales in the market (only two work at a time) and one boy to assist in his studio, and he pays a family near the market to store his wares each night.

Each of these activities takes place in the open, and each is illegal, although not all are flagrantly so. Repairmen with licenses may work individually, but not in partnership. Cubans may sell fruit, but only with a license in a farmers market. The maids, laundry service, assistants to the artisan, and “promoters” who earn commissions by matching customers with restaurants and private lodging, are all unlicensed but are ancillary to legal self-employment. The beef and cheese vendors are engaged in activities that the state reserves to itself. Then there are businesses that fit anyone’s definition of “black market”—sales of goods pilfered from the state, provision of satellite television access from clandestine receivers, or sales of black-market internet access from servers housed in state facilities.

These and countless other examples illustrate that entrepreneurship in Cuba is not limited to those who hold licenses. Indeed it is hard to observe these daily occurrences in Cuba and not conclude that licensed *cuentapropistas* are vastly outnumbered by people with off-the-books business activities.

Conclusion

In a 1999 article, Cuban economists Luis Marcelo Yera and Oscar U-Echevarria Vallejo discussed the role of small and medium-sized enterprises in Cuba's economy. They provided an early view of the official attitude that would later restrict self-employment based on confidence in the state's capacity to plan economic development and allocate resources.

These economists identify problems associated with small enterprise, whether public or private: inability to obtain advanced technology, insufficient capital, a tendency to become "a refuge for the low-skilled workforce," accumulation of capital in private hands, and a high rate of "infant mortality"—business failure—where each failure is a "loss, in public and private terms, of invested capital and time, not to mention personal anguish" for those who lose jobs. They view state enterprises as flexible, agile, and independent, capable of being innovative and competitive "without having to pass through the long and torturous road of ferocious, anarchic competition." Their ideal is a large state enterprise within a group of businesses, called the *union corporativa*.

This view is the polar opposite of that which prevails in market economies, which highly values those who take risks to start small businesses, whether high-tech or not. They are valuable even when they fail, because they are part of a proving ground where ideas that do not work, do not prosper.

While Cuba claims an unemployment rate below two percent, there is considerable under-employment in its workforce because state salaries are low relative to the cost of living, and there is a shortage of well-paying jobs in tourism and other sectors.

The benefits of Cuba's *trabajo por cuenta propia* are clear: jobs, higher-than-average incomes, a supply of goods and services for the domestic and tourism markets, and reduced demand for social welfare services. To the state, the costs include a small measure of competition with its own enterprises, a portion of the workforce that is outside the political structures connected to the government's own workplaces, incentives for some to engage in black-market activity to supply their businesses, and a substantial amount of beneficial economic activity that is driven underground.

If Cuban officials one day decide to change policy, Cuba's experience since 1993 demonstrates that there is opportunity in the small enterprise sector.

There is probably no simpler way for Cuba to jump-start growth of output, incomes, and employment than to allow greater scope for small enterprise, for example by allowing partnerships or the hiring of employees, creating a wholesale supply system, and avoiding prohibitive tax rates. Results could be obtained even within a socialist framework that rigorously regulates and



taxes entrepreneurs and limits their ability to compete with key state industries. Tax revenues would rise as businesses now underground come into the legal economy, and as new entrants try their entrepreneurial luck.

The economic logic is hard to dispute; what is in doubt is whether Cuban officials would ever make the philosophical shift that would make these policies possible. Until then, the *cuentapropistas*' story is one of limited success and untapped potential.

Slowly disappearing home restaurants

Cuba's home-based restaurants, called *paladares* (they took their name from a popular Brazilian soap opera that aired in Cuba), first appeared in the early 1990's and served a Cuban public suffering from dire food shortages.

More than most lines of self-employment, the *paladares* have been affected by the government's changing policies. In May 1996, 1,788 were operating across Cuba, according to official figures; press reports indicate that fewer than 200 operate now.

The *paladares* were first buffeted by the introduction of income taxes in 1996, by subsequent tax rate increases, by regulatory enforcement that at times seems reasonable (sanitation inspections) and at times arbitrary (imposing fines for those who cannot document the origin of all supplies). All are limited to twelve seats.

But it is also clear that these private restaurants suffered the effects of competition. In their early years, they had minimal competition from a few state restaurants, mainly in hotels, none of great quality and none as interesting as the *paladares*, with their informal, home-style settings.

But as the tourism industry grew, there developed a variety of state restaurants in hotels and in many settings outside them in cities across Cuba. They may have shortcomings, but nothing resembling them existed in the early 1990's in terms of quality, variety, and ambience. They pose a strong competitive challenge to their private sector counterparts.

Many are in choice settings with attractive architecture. They take advantage of the prohibition on *paladares* serving beef and shellfish. And as *paladar* prices have risen in response to tax increases, *paladares* are no longer a bargain.

Among the *paladares* that remain in Havana are several that are long-established and of high quality and that flaunt legal requirements so blatantly—seating more than twelve, including prohibited items on the menu—as to make one wonder whether they have a special arrangement with the authorities.

In Santiago last year, something new and different may have been operating: a state restaurant masquerading as a *paladar*. A hotel security guard indicated the location of *La Terraza* five blocks from a central plaza. There was a doorman who went to theatrical lengths to portray the place as clandestine, cracking the door open as guests prepared to leave and not allowing them out (“A question of security,” he explained) until the coast was allegedly clear. Up two flights of stairs, there was a rooftop terrace with seating for at least three times the legal limit of twelve guests. Shrimp and lobster were on the menu, a second blatant violation. Service was indifferent and food quality was poor. One was left to believe either that this was a private restaurant that has outfoxed Cuban police in a major urban center, prospering with bad food and service, or that it is a state restaurant that was established to meet European tourists' steady demand for *paladares*.



Interviewees were granted anonymity; where names are used they are pseudonyms.

Photos by the author.

To contact the author: peters@lexingtoninstitute.org

The Lexington Institute gratefully acknowledges the financial support from the Ford Foundation that made this study possible.



1600 Wilson Boulevard, Suite 900

Arlington, Virginia 22209