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The dual currency *bifurcation of Cuba's* economy in the 1990s: *causes, consequences* and cures

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In the 1990s, there has been a growing split in Cuba's economy between the traditional socialist peso-based component and the internationalized dollar-oriented and marketized component. This schism has been caused by a conjuncture of circumstances, including the expansion of tourism and foreign and mixed enterprise; the contraction and loss of confidence in the socialist economy; the weakening of the monetary role of the peso (owing to the rapid inflation arising from the financing of the fiscal deficit through money creation), and a grossly overvalued exchange rate. This dual currency and structural bifurcation of the economy shaped the pattern of income distribution, thereby influencing the economic behaviour of the Cuban people. Cubans with access to U.S. dollars in the internationalized part of the economy have higher incomes than those without such access, owing to the difference between the unofficial exchange rate and the official (commercial) rate. Because of this situation, Cubans performing valuable social functions in the socialist economy are rewarded meagerly by society while those in the internationalized economy are relatively well rewarded. In consequence, Cubans "chase dollars" by any means possible –legal, semi-legal, or illegal. The bifurcation has thus stimulated the return of a variety of social ills which had virtually disappeared by the early 1960s. Some recent policies, notably the fiscal policies of 1994 (which lowered the deficit, decelerated monetary emission and reduced peso inflation, thereby increasing the demand for pesos), and some institutional changes have helped to reduce the unofficial exchange rate and to reduce the bifurcation. However, it will be necessary to continue and intensify this process of change in order to reintegrate the economy. Specially important elements in this respect will be exchange rate policy, further liberalization of small and medium-sized enterprise, and decontrol of prices (which will also call for the redesigning of the social "safety net").

I

Introduction

In the first half of the 1990s, in particular, Cuba's economy became increasingly split between the traditional socialist economy based on the old peso, on the one hand, and the rapidly expanding internationalized dollar-based economy together with the domestic market-oriented peso economy, on the other hand. These two parts of the economy interacted in a number of ways to generate a severely dysfunctional structure of incentives shaping people's economic energies in counterproductive ways and generating pervasive economic irrationalities. The reintegration of the economy is therefore necessary if human, natural and capital resources are to be used productively: presumably a major imperative in the current situation of severe depression. Reunification of these parts of the economy into a market-oriented system is vital if economic recovery, adjustment and transition are to occur.

Reintegrating these two parts of the economy will require a battery of policy changes which will be economically, politically and socially difficult in the short term. The policy areas must include the exchange rate, the monetary system, price decontrol, enterprise liberalization, harnessing of the mixed public and private "Sociedad Anónima" conglomerates, and redesigning of the social safety net. Indeed the task of unifying the two parts of the economy is a central feature of the general processes of both adjustment and transition.

The objective of this essay is to explore the characteristics, functioning, origins and consequences of the bifurcation of the Cuban economy in the 1990s and to examine the policy changes required to reintegrate the economy. In section II of this paper, the dualistic structure of the economy is described and the mechanics of its functioning are analysed. Next, in section III, the general economic consequences of this bifurcation are examined. The official approach to dealing with the bifurcation as of the first half of the 1990s is discussed in section IV, and finally, the policies required to "heal the split" or to reintegrate the two parts of the economy are analysed in section V.

It must be noted that a structural analysis of the Cuban economy in the 1990s is difficult to undertake due to the lack of concrete information. Since 1989, the Cuban government has not published comprehensive statistical data on the economy of the sort published between 1970 and 1989.¹ But the extent of the bifurcation of the economy was not really observed prior to about 1993. Some of the important policy changes which have been connected with the bifurcation—the legalization of the use of the U.S. dollar, the legalization of self-employment, and the establishment of agricultural markets, for example—were only introduced since mid-1993, so that there has been little time to reorganize information gathering and publication by the private and public sectors.

□ A number of people have provided valuable comments and critiques on this essay or have participated with me in informal discussions of Cuba's current economic situation. Among these are Carl McMillan and Keith Acheson of Carleton University in Ottawa, Canada, and Nobina and Keith Robinson, who are currently in Havana, Cuba; Francisco León, Joseph Ramos, Jorge Katz, Juan Carlos Lerda and Michael Mortimore, of ECLAC, Santiago, Chile; and various analysts and observers of the Cuban situation. The responsibility for the interpretations, analyses and any errors in the essay, however, lies of course with the author.

¹ Even Cuban economic analysts in the universities and numerous research institutes are reduced to relying on the newspaper *Granma* for the basic statistical materials for much of their work on the Cuban economy. Such official secrecy concerning information on the economy cannot fail to lower the quality of economic analysis at a time when good analysis is of the utmost importance for the rethinking and redesign of economic policy. Forcing Cuban analysts to work without good basic information obstructs their endeavours to contribute to an understanding of the economy and wastes their talents and energies.

II

The dual currency character of the Cuban economy

In the early 1990s the predominant characteristic of Cuba's economic structure was its bifurcation between the traditional socialist peso-based economy and the internationalized dollar-based part of the economy. The former was in a state of deep depression, organizational collapse, loss of confidence and general retreat. In contrast, the internationalized dollar-based part of the economy was expanding rapidly despite the recession, due to the increasing role of tourism and foreign investment, some public policy changes, and the vacuum left by the contraction of the traditional peso-based economy. The expansion of the internationalized part of the economy was reflected in two elements: first, an increase in dollar-oriented types of activities, including tourism, the presence of foreign businesses in joint ventures, various auxiliary goods and services, and dollar remittances from abroad, and second, the development of intermediate or transitional forms of market and quasi-market-oriented economic activity, including self-employment (both official and in the underground economy) and the economic activities operating through markets.

1. Characteristics and functioning

In mid-1995, the traditional socialist peso-based economy encompassed almost the whole of industry, with the exception of self-employed artisanal and industrial workers and some export-oriented joint ventures. Services also mostly came under this sector, including all of finance, most business services, some personal services (except those provided through self-employment), most wholesaling and retailing (except for the agricultural, industrial and artisanal markets), most transportation, and all communications. The role of the traditional socialist economy in agriculture was modified considerably as a result of the formation of the "Unidades Básicas de Producción Cooperativa" (UBPCs) in mid-1993. With the establishment of these cooperatives, the State sector's share of total agricultural land fell from 75% to 34%, while its share of cultivated land fell from 80% to 25% (see table 1). The role of the State as the provider of inputs and auxiliary services and purchaser of output quotas at controlled prices is still significant, however. It is not yet completely clear how authentically cooperative and

TABLE 1

Cuba: Land tenure, March 1994

	Hectares	Sectoral shares (%)			
		State	Cooperative	Private	UBPC ^a
<i>Total Area</i>	11 048 000	55.5	7.5	9.8	27.2
Agricultural land	6 741 000	34.0	11.0	14.0	41.0
Cultivated land	4 723 000	25.0	9.0	11.0	55.0
Under irrigation	964 000	25.0	8.0	6.0	61.0
Selected crops					
Sugar cane	1 918 000	9.0	12.0	2.0	77.0
Rice	191 000	41.0	9.0	12.0	38.0
Vegetables	524 000	16.0	15.0	48.0	21.0
Tobacco	57 000	11.0	12.0	49.0	28.0

Source: CONAS, 1994, p. 75

^a Basic cooperative production units.

autonomous the UBPCs will turn out to be. Nevertheless, the potential significance of this change in land tenure in Cuba is very considerable.

Within the traditional socialist sector, resource allocation was undertaken prior to 1990 through a centralized planning system, with the volume, mix and destination of enterprise outputs, the mix and origin of enterprise inputs, the pattern of investment within and among sectors and industries, and the nature of the external interlinkages of the enterprises all being ostensibly determined by the "Plan". The impossibility of planning all these aspects adequately resulted in much improvisation and heavy reliance on "sociolismo", that is, the solution of economic problems by the exchange of favours through circles of friends. The centralized system deteriorated with the problems of the 1990s and was replaced by ever-greater improvisation and "sociolismo". In this part of the economy, consumer goods are allocated through the rationing system for some basic foodstuffs and household necessities (with decreasing quantities from 1990 to 1994, it might be added) or on the basis of political considerations (in the case of cars, housing, consumer durables and foreign travel, which are allocated to politically deserving designated individuals).

The prices of virtually all consumer goods provided through the rationing system were frozen at, or close to, their 1960-1962 levels. Labour was allocated to sectors, industries and specific activities not through decentralized market processes but through centrally-taken decisions (with some individual choice of careers and economic areas, and with the State guaranteeing first-time job seekers employment in the areas of their educational training). In this sector, labour force remuneration is confined to a relatively narrow wage and salary scale (from about 80 to 480 pesos per month), supplemented by politically allocated items, at very low prices, and more recently by some hard currency (and after December 1994, convertible peso) payments to workers in certain important sectors (electrical generation, oil production, some fishing, port activities).

The internationalized dollar-based part of the Cuban economy consists of tourism and auxiliary services, foreign businesses operating with Cuban partners in joint ventures, and some of the large mixed enterprises and "Sociedades Anónimas" (these are State-owned but financially and manage-

rially autonomous conglomerate enterprises operating in the internationalized dollar-oriented economy and behaving much like private enterprises). By the mid-1990s, some State enterprises were undertaking work for the tourist sector for compensation in hard currency, and some special farm operations were being established to produce fresh vegetables for the tourist sector, with payment also in dollars. The "remittance economy" (those receiving dollars from abroad and spending them in the domestic market economy or "dollar stores") would also be included here. The domestic market economy—registered and unregistered self-employed persons, the agricultural, artisanal and small-scale industrial markets, and to a much lesser extent the UBPCs—likewise forms part of this sector of the economy. Although the private agricultural sector only accounts for 14% of total agricultural land, its share of agricultural value added is probably greater because of its disproportionate share of high-value crops such as vegetables and tobacco (see table 1).

The important role of the UBPCs in agriculture has already been noted, but their evolution is still unclear, and they might be considered to be in an early transitional state. Some personal services are provided through the market mechanism, at prices determined by market forces. Self-employed individuals produce a large proportion of artisanal products, but only a small amount of employment and value added would be generated by this sector in manufacturing and industry. There appear to be no estimates yet available for the new and rapidly changing structure of employment or value added according to public or private sector, marketized or non-marketized activities.

In this part of the economy, resource allocation occurs largely or partly through market mechanisms. For the self-employed, and for exchanges in the agricultural, artisanal and small-scale industrial markets, prices are determined by the forces of supply and demand within what often must be highly competitive markets with considerable ease of entry. In the artisanal markets, prices are expressed in pesos or dollars at the unofficial exchange rate and transactions may be in dollars or pesos. The agricultural and industrial market transactions are by law supposed to be only in pesos, but money-changers readily convert dollars to pesos at the prevailing unofficial exchange rate. Transactions with the self-employed can take place

in dollars or pesos, likewise at the unofficial exchange rate. The whole tourist sector, as well as the foreign business sector, operates in U.S. dollars. The "dollar stores", which now include a number of chains of stores importing foodstuffs, clothing, footwear, appliances, consumer electronics and other durables, and even candy, soft drinks and alcoholic beverages, as well as restaurants for foreigners and Cubans alike, are designed to "mop up" some of the dollars (and "convertible pesos") in circulation, with a substantial tax-equivalent profit received by the State.

Remuneration and earnings in this part of the economy are determined largely by market forces. For those who are legally or illegally self-employed, incomes are determined by the relative demand for the goods or services offered, *vis-à-vis* the nature of the competition and the production costs. This applies to all of the 166 categories of registered own-account workers legalized as from 12 June 1995, to those who were self-employed in the legalized categories but not registered, and to those providing goods or services which were still illegal at this time (e.g., some professional services.) For those in the tourist sector or providing auxiliary services, tips in foreign currency constitute the main remuneration. In the foreign business sector, foreign factors of production must be paid for in foreign currency, otherwise there would be no incentive to operate in Cuba. Cuban employees of foreign business are supposed to be paid in pesos; supplementary payments in dollars are illegal, but hard to prevent totally when enterprises find that maintaining labour force commitment requires such supplementation. The receipt of dollar remittances is, of course, not a remuneration for services rendered but a gift from relatives abroad.

2. The forces generating the dual currency bifurcation

The bifurcation of the Cuban economy into the peso-based and dollar-based components is mainly the result of economic policies and the institutional structure of the economy, together with the economic liberalization process.

These factors have interacted to generate the bifurcation as follows. First, with controlled, low prices in the State sector for rationed goods and services, the payments to human factors of production have

traditionally exceeded the value of goods and services available for purchase. The excess of remunerative payments over the value of rationed goods and services available increased sharply from 1989 to 1994 as the volume of output shrank. This was possible because price controls prevented any increase in prices, while the government was willing to cover the worsening operating deficits of State enterprises with grants which were financed by the printing of money or the creation of unredeemed and unredeemable credits. The creation of money, namely old pesos, for this purpose then generated the inflationary dynamics described above.

Second, this excess volume of money earnings then fed into the black market, putting upward pressure on the prices of goods and services in that part of the economy. Rising prices continued even after self-employment legalized some of the activities outside the controlled "socialist" economy. Such rising prices constituted by definition inflation, even though the official position until recently was that there was no inflation because of the price controls on the rationed goods and services. Third, as inflation continued and accelerated, reflecting the growing monthly excess of money earnings over the value of goods and services available in the socialist economy, it increasingly devalued the peso with respect to the value of the U.S. dollar. With worsening real inflation, what was happening was that Cubans were losing faith in the peso as a currency and turning to the U.S. dollar as a "money" for the performance of monetary functions.

Ultimately, by mid-1994, the value of the U.S. dollar reached levels as high as 100 to 120 pesos in the unofficial market, this peso devaluation being probably due to: i) the high demand for dollars by the "balseros" who were trying to convert their assets to dollars for transfer out of the country, or for the purchase of rafts; ii) extreme shortages of items which could be legally purchased for pesos at the time, and iii) a growing air of pessimism, loss of confidence and desperation on the part of many Cubans with respect to the prospects for the economy. The unofficial exchange rate subsequently declined somewhat, especially after the opening of the agricultural markets on 1 October 1994, which increased the demand for pesos and led to declines

in the prices of foods in terms of their earlier black market levels. The rate fell as low as 30-35 pesos to the U.S. dollar by April 1995, but appeared to be rising again by June 1995. Even at such a rate, the difference from the official rates –1 peso = US\$1 for tourism and 0.74 pesos = US\$1 for commerce– is most extreme in comparative historical terms.

Exchange rate policy and protectionism have also played an important role in the generation of this bifurcation. The socialist peso-based economy has an exchange rate of 0.74 pesos = US\$1, which makes imports of all sorts exceedingly cheap in terms of pesos and results in an impossibly huge demand for imports (far beyond what could conceivably be purchased with Cuba's foreign exchange earnings), which has to be limited by bureaucratic controls or non-tariff barriers (NTBs) to provide infinite protection against some imports or to allow other imports (medicines and foodstuffs, for example) to be brought in at the official exchange rate so that their cost to Cuban consumers is maintained at a low peso purchase price. This type of bureaucratic NTB has provided most of the socialist peso-based sector with impenetrable and infinite protection against competitive imports of final products. At the same time, some imported inputs, replacement parts and machinery and equipment have been permitted to enter the country at a zero tariff, thus constituting a major subsidy for the enterprises enjoying the right to import at the official rate. On the other hand, if the foreign exchange earnings from the exports of the traditional socialist economy are converted to pesos at the official rate, such enterprises earn very little and there is a major disincentive to expand and diversify exports.

The big dollar-oriented Sociedad Anónima conglomerates also use the official exchange rates. However, because many of these operate largely or partly in the internationalized part of Cuba's economy (in tourism, dollar-store retailing, export-import trade, or servicing foreign business, the diplomatic corps, or international organizations) they are empowered to import commodities at zero tariff. These com-

modities are then sold to tourists, Cubans with dollars, foreign business people, etc., duty free, but often with a substantial price mark-up which constitutes in effect a tax. So far the import bias of these conglomerates has been countered by various rules and directives designed to redirect their purchasing towards domestic sources.

Microenterprises have no right to import inputs at one of the official exchange rates, as they are not in priority areas of the economy, nor have they yet organized themselves into lobby groups which could petition the government for access to some imports at the official rates. Indeed, the microenterprise sector does not even have the right to obtain imports directly from abroad at the black market exchange rate, although inputs which have already been imported do reach this sector indirectly.

Thus, Cuba is in the paradoxical situation of having a highly variable and discriminatory system of effective protection and subsidization of imports through bureaucratic NTBs and extreme exchange rate overvaluation under which: i) the traditional socialist economy is subject to a wide range of NTBs, plus the overvaluation of the currency; ii) the transitional market economy faces virtually endless NTBs; and iii) many of the foreign-exchange-earning Sociedades Anónimas enjoy free importation of many goods at the very favourable official exchange rate.

Finally, the expansion of tourism and the growing presence of foreign business in the 1990s have contributed to the expansion of the internationalized dollar-oriented economy. From 1990 to 1993, the number of tourists increased from about 340 000 to 550 000, while gross income from tourism increased from US\$189 million to US\$720 million, although the value added within Cuba constituted only about 30% of gross income in 1994, according to officials of the Ministry of Tourism (16 February 1995). Likewise, a growing number of foreign businesses have established branches or entered into joint ventures with Cuban State enterprises. Tourists, foreign businessmen and foreign businesses must all operate with dollars.

III

Consequences of the bifurcation of the economy

1. Income distribution and the general structure of incentives

The most important and best-known consequence of the bifurcation concerns income distribution and the general structure of incentives. Essentially, in the traditional socialist economy the wage and salary structure ranges from about 80 to 480 pesos per month. At the unofficial exchange rate (40 pesos per U.S. dollar in early 1995), this is equivalent to US\$2.00 to US\$12.00 per month. At the commercial exchange rate of 0.74 pesos per U.S. dollar, the level of incomes is obviously much higher, but this exchange rate is virtually meaningless for private citizens.

On the other hand, those who are able to earn or receive foreign currency, especially U.S. dollars (through work in the tourist sector or auxiliary services, the foreign business sector, services provided outside of Cuba for convertible currency, or remittances from relatives abroad) can enjoy substantially higher real incomes. For example, a bartender or elevator operator in the tourist sector may receive an average of, say, US\$30.00 per month in tips, which would be equivalent to some 1 200 old pesos per month: up to 1000% of the peso income of a person with similar qualifications working elsewhere in the economy, and up to 250% of the top of the peso wage and salary scale. Similarly, an engineer who drives his car as an unregistered taxi might earn US\$50 to US\$150 per month (or even much more), which would be around 2 000 to 6 000 old pesos or 8 to 20 times the peso income which could be earned in the traditional socialist economy. These examples could be multiplied *ad infinitum*.

Those who are self-employed or who sell their goods or services on the market also usually receive higher incomes, because the prices at which their sales are made are market-determined in the context of the excess money incomes which most Cubans have after they have spent their old peso incomes on the rationed commodities. However, these prices and hence the incomes of the self-employed are constrained by the relative "freedom of entry" into

registered (or unregistered) market activities, with the large numbers of competing self-employed tending to keep prices and incomes down. Low barriers to entry, plus the increase in the number of potential entrants to this micro-enterprise sector (due to the present and probable future downsizing of State enterprises, public services and some of the professions) should push prices and incomes to even lower levels in future.

Generally speaking, the internationalized dollar-oriented economy generates income levels which are usually high in comparison with the incomes generated in the traditional socialist economy. Though the gap in real incomes may be less than the apparent gap in nominal old peso terms, the gap can be and often is very large. People's incomes in old pesos permit the purchase of rationed foodstuffs, but the rations available per month usually lasted for only 7 to 14 days by 1994, leaving serious family food shortages. Incomes in old pesos typically would also permit the purchase of other rationed goods such as household and personal hygiene products and some items of clothing per year. But for the purchase of foodstuffs from the agricultural markets (or, prior to 1 October 1994, from the black market) and from the industrial and artisanal markets, large amounts of pesos are required as these prices are market-determined. For purchases of foodstuffs, personal hygiene products, clothing, footwear, or consumer durables from the "dollar stores", dollars or "convertible pesos" are naturally required.

The implications of this pattern of income distribution for the general structure of incentives which shape people's activities in their material lives are obvious. Because the real value of incomes in old pesos in the traditional socialist economy is low in comparison with the value of real incomes in the internationalized dollar-oriented economy and the market-oriented economy, people in effect choose the latter. In other words, Cubans tend to chase dollars. In practical terms, this means that professors with a knowledge of English or some other tourism-oriented language move to the tourist sector; young men and women who should be focusing on their school work

in preparation for a job in the public sector or professions switch to being "jineteros" or "jineteras"; nurses leave their employment to earn dollars, etc. Even people with quite good jobs in the traditional socialist economy are under great pressure to earn or acquire dollars or large amounts of old pesos through self-employment or part-time provision of services ("moonlighting").

From the standpoint of society, it is regrettable that those who carry out functions in the traditional socialist economy which are often of great importance to the community (in education, health, and agricultural and industrial work, for example) are poorly rewarded, while other activities which may be less important for society (e.g., selling cigars on the street) are highly rewarded. Indeed, the irony of the situation is that those who have been among the strongest supporters and beneficiaries of the Revolutionary regime in the traditional socialist economy (soldiers, workers, educational and health professionals) have been suffering material deprivation, whereas Cubans who have maintained good relationships with family members abroad, small-scale entrepreneurs and hustlers of various sorts receive substantially higher incomes, either in dollars or through better-rewarded self-employment.

2. Implications for resource allocation: market forces, "micro-irrationalities" and dysfunctionality

The high incomes and resulting incentives for people who shift their energies to the internationalized dollar-oriented economy and away from the traditional socialist economy are ultimately a market-driven phenomenon. In some ways, they are a normal or natural response to the increased importance of foreign exchange and imports following the loss of some 70-75% of Cuba's capacity to import. Shifting resources towards the foreign-exchange-earning sector (tourism in this case) is a necessary part of the process of Cuba's structural adjustment, so that foreign exchange earnings can increase and import levels can rise above their very low current level. The shift of resources to the internationalized sector is "market-driven" in the sense that real economic scarcity of imports of all sorts is a major force pushing the black market exchange rate to high levels.

Unfortunately, some of the key foreign exchange earning sectors, such as sugar, citrus fruit and coffee,

are in the traditional socialist economy and not the internationalized part, so that their revenues are in pesos at the official commercial rate of US\$1.00 = 0.74 pesos. Consequently, unlike tourism, these sectors do not receive the benefit of the hard currency they earn for the country. Instead, their low remuneration in real terms results in shortages of inputs of all kinds, and especially imported inputs such as replacement parts, new capital equipment and intermediate inputs. Further consequences of this situation include the ongoing deterioration of the capital stock and especially loss of human resources, as employees leave their employment in the traditional peso economy in an attempt to earn dollars or larger amounts of pesos through self-employment. The severe discrimination against most foreign exchange earning sectors which results from the dual currency bifurcation must be one of the most destructive irrationalities in the functioning of the Cuban economy during the mid-1990s, when the need for foreign exchange is so urgent.

While there is an underlying economic logic to the reallocation of resources to the internationalized and domestic market economy, there are also pervasive micro-irrationalities in the functioning of the economy which add up to a giant economic dysfunctionality. Because of the controlled and very low prices in the traditional socialist economy, a variety of goods and services can be purchased at the controlled prices and resold at higher market-determined prices in pesos or dollars (at the black market exchange rate). Likewise, commodities in the socialist economy can leak out by theft or graft of various sorts and be resold at the high market-determined prices. There are numerous examples of this. For example, rationed rum can be purchased at the controlled old peso price and resold at a much higher price. Virtually any foodstuff acquired at the official price can be resold at a high profit. Gasoline acquired at the rationed peso price can also be resold for dollars, and any item imported at the official commercial exchange rate can be resold at a much higher black market or dollar price.

The result of the myriad of profit-making opportunities arising from price controls and imports at the official exchange rate is a massive volume of "rent seeking". It is highly remunerative for people to devote their creative economic energies to buying and selling between the two economies. Indeed, often the profits to be made on the purchase of an item for

pesos in the socialist economy and its resale in the internationalized or domestic market economy are so large that it is more remunerative for people to leave their formal employment altogether (or preferably to resort to continued absenteeism) and to devote themselves to "rent-seeking". The consequence of this ubiquitous practice is that the productive work of the population is de-emphasized and ignored, while disproportionate amounts of energy are devoted to buying and selling, although some of the transactions would be needless or of limited usefulness under more normal circumstances.

The second type of irrationality concerns the high cost in real terms which Cuba as a society pays to reallocate human resources to the internationalized economy. While this reallocation is necessary in the current circumstances and always involves some kind of costs, one cannot help but feel that the costs involved are excessive under the dual currency economy of the mid-1990s. For example, is it really appropriate to remunerate doctors, nurses and factory workers in old pesos and at the old wage and salary scales while unskilled workers in tourism receive much higher real incomes through their tips? While one hesitates to make value judgements of this sort, it does appear that Cuban society devotes a large volume of real resources to incentivate and remunerate such individuals in the dollar-oriented economy, while those in the fixed price peso-oriented economy are rewarded meagerly.

3. Social consequences of the bifurcation

Interacting symbiotically with the decline in Cuba's real per capita income since 1989, the dual currency bifurcation of the economy has generated a number of negative social consequences. These include the impacts on income distribution, work habits and "rent-seeking," difficulties in maintaining "one-tier" systems for the provision of basic social services, and the re-emergence of social ills which had been virtually eliminated in the early years of the revolutionary regime.

As already noted, income distribution has been affected significantly by the dual currency bifurcation. Those people who worked in the socialist economy and had no access to U.S. dollars were in effect penalized and were receiving very low real incomes by 1993-1995, whereas those who were able to earn or receive U.S. dollars or who were earning market-

determined peso incomes were generally faring quite well. It may be added that those with privileged access to some imported items (e.g. cars and gasoline) at the official exchange rate and those with access to some privileged consumption through their connections with important institutions were also doing relatively well, as was also the case before 1990. This pattern of income distribution is a social problem in that groups of people who perform valuable services for society but work in the traditional peso economy are penalized with low real incomes, whereas "rent-seekers" who devote their energies to intermediating between the two economies may receive very high incomes by providing services which would be unnecessary and unprofitable if Cuba's economic structure were unified rather than bifurcated.

A further consequence of the bifurcation operating with the decline in real incomes is the reemergence of begging, hustling, prostitution or quasi-prostitution and crime. All of these ills had largely disappeared or been greatly reduced by the mid-1960s, but all re-emerged on a large scale and very conspicuously by the mid-1990s. By 1994, foreigners—who seemed to be easily identifiable by Cubans—would be approached and asked for dollars. In Havana, this was done most often by children, but also by pensioners and mothers with children. This begging did not seem to be full-time professional begging of the sort one encounters in some Asian countries, but appeared rather to be a part-time activity undertaken by adults when they were desperate, in the context of a situation where US\$1.00 acquired by begging was equivalent to 35-50 old pesos, which was for many a week's wage or more. Begging by children may sometimes be due to the extreme poverty of the family, but it also sometimes seems to be of a much less urgent character, as children often use their dollar receipts from begging to buy imported candy, soft drinks, etc. (conveniently sold in vending machines and kiosks owned by the *Sociedades Anónimas*).

"Hustling"—quasi-legal or downright illegal "rent-seeking"—has emerged on a major scale. Young men, the so-called "jineteros," seek to acquire dollars by reselling boxes of cigars, bottles of rum or some "medicines", or by procuring women or providing companionship for persons in the internationalized part of the economy. Young women or "jineteras" provide companionship or sexual services for men in the internationalized economy, often earning very

high incomes. Many of them appear to operate on a part-time income-supplementing and amateur basis rather than as full-time professionals, but little firm evidence is available on this activity despite its conspicuousness and scale.²

Crime is said to have increased significantly. Comments among the people, and the security systems used in the internationalized economy, together with the security precautions that most people now take in Havana suggest that the large income gap between the traditional socialist peso-based economy and the internationalized dollar-based economy has increased the incentive for theft. Unfortunately, there are no statistics with which one might corroborate or disprove this.

Finally, the dual currency bifurcation of the economy, plus the economic contraction, are making it difficult to maintain a good-quality one-tier educational and health system. The public health system has deteriorated seriously due to lack of imported inputs, low budget allocations, and very high absenteeism on the part of hospital staff. Medicines are also often very scarce in the peso economy. As a

result, people with access to U.S. dollars often use them to purchase medicines in the dollar stores or to supplement the meals, supplies and medical items available in the hospitals. It does not seem likely that many doctors are providing medical services outside the State system for dollars or market-determined fees, since this is highly illegal and doctors have been explicitly prohibited from entering private practice (self-employment). However, in line with traditions long predating the Revolution, it seems that in some areas patients make supplementary payments in kind for medical services. At all events, it appears to be becoming more difficult to prevent the gradual shift to a two-tier medical system, which would be a major departure from the regime's commitment to provide similar medical care for all. In education, there seems to have been a deterioration in quality, according to what people say, as teachers reduce the time and attention devoted to teaching in order to acquire dollars or supplement their incomes in old pesos. Consequently, some parents are increasingly paying for extra-curricular instruction for their children or teaching them themselves.

IV

Reunifying the economy (1993-1995)

The government only seems to have become fully aware of the increasing dual currency bifurcation of the Cuban economy after the decriminalization of the use of the U.S. dollar in the summer of 1993. This measure perhaps made the bifurcation of the economy and its consequences easier to grasp, but the real bifurcation existed as far back as the mid-1980s and became severe after about 1990. It is interesting to note that some of the main analyses of the Cuban

economy before about 1994 do not refer to or analyse this phenomenon (Carranza, 1993 and Lee, 1993, for example). The appointment of Dr. José Luis Rodríguez as Minister of Finance signalled a greater concern on the part of the government with the worsening fiscal deficit (financed by money creation) and its implications. The support which Dr. Rodríguez then enjoyed and the adoption by the National Assembly of a package of measures designed to reduce the fiscal deficit indicated that by 1994 the underlying causes and the negative consequences of the bifurcation were better understood.

A number of the reforms introduced after the summer of 1993 have had the indirect or direct result of decelerating or reversing the bifurcation.

1. Fiscal policies

The set of measures enacted in 1994 by the Ministry of Finance to reduce the fiscal deficit have helped to

² Mirta Rodríguez Calderón, a journalist and co-founder of MAGIN (Asociación de Mujeres Comunicadoras), maintains that "jineterismo," as practiced by young Cuban women, is not necessarily the same as the sale of sexual favours for cash and is thus quite distinct from pre-1959 prostitution in Cuba. Often dining, concerts, dancing, sight-seeing, visits to the dollar store, or companionship are involved, but "the meter is always ticking". Some young women cherish the hope of marrying a foreigner and leaving the country, and young men also provide such companionship for foreign women, sometimes achieving marriage and emigration in this way (Strout, 1995, p. 3).

reduce the tendency towards bifurcation. By reducing the deficit from about 5.1 billion pesos in 1993 (some 28% of estimated GDP) to an estimated 1.4 billion pesos in 1994 (about 7-8% of GDP), the volume of money created to finance the deficit was reduced significantly (*Granma Internacional*, 1995, p. 4). The result of this has been a reduction in the excess of old pesos fed into the economy over and above the value

of price-controlled goods and services, thus also reducing the upward pressure on black market or market-determined prices as well as on the black market price of the U.S. dollar. If the fiscal deficit declines further in 1995 as a result of these tax increases and expenditure cuts, uncontrolled prices and the unofficial exchange rate for the U.S. dollar should rise at a still slower rate.

TABLE 2

Cuba: Main economic indicators, 1985-1995

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Estimated GDP (\$US, billion)	32.3	32.6	31.4	32.2	32.5	31.5	23.6	20.3	18.3	18.4 ^e	...
Estimated per capita GDP (\$US)	3 181	3 182	3 032	3 076	3 076	2 971	2 226	1 897	1 679	1 640 ^e	...
Change in per capita GDP (%)	(3.5)	-	-4.7	1.5	-	-3.4	-25.1	-14.8	-11.5	-2.3 ^e	...
Per capita GDP, index (ECLAC)	100.0	99.7	95.4	96.5	96.4	92.5	68.7	58.6	52.4	51.8 ^e	...
Total exports (\$US billion)	5.99	5.32	5.40	5.52	5.4	4.9	3.6	2.2	1.7	1.8 ^e	...
Total imports (\$US billion)	8.04	7.60	6.58	6.58	8.1	6.7	3.7	2.5	2.2	2.3 ^e	...
Hard-currency external debt (\$US billion)	3.9	6.0	5.7	6.5	6.2	7.0	8.4	10.0	10.8
Budget deficit (Billions of pesos)	0.3	0.2	0.6	1.1	1.4	2.0	3.7	4.2	5.1	1.4 ^e	...
As a percentage of estimated GDP	0.9	0.6	1.9	3.4	4.3	6.3	15.7	20.7	27.9	7.6	...
Sugar harvest (Millions of metric tons)	7.9	7.5	7.2	8.1	7.6	8.4	7.2	7.0	4.3	4.0	3.5 ^e
Petroleum imports (Millions of metric tons)	13.5	13.2	13.5	13.4	13.3	11.6	9.2	6.2	5.7	6.2	...
Petroleum production (Millions of metric tons)	0.9	0.9	0.9	0.7	0.7	0.7	0.5	0.9	1.1	1.3	1.4 ^e
Total petroleum (Millions of metric tons)	14.4	14.1	14.4	14.1	14.0	12.3	9.7	7.1	6.8	7.5	...
Exchange rates											
Official tourist rate (Pesos/\$US)			1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Official commercial rate (Pesos/\$US)			0.74	0.74	0.74	0.74	0.74	0.74	0.74	0.74	0.74
Unofficial rate (Pesos/\$US) ^b					5	7(9)	20(12)	35(7)	55(6)	100(11)	35(10)

Source: CONAS, 1994; CEE (C6mite Estatal de Estadisticas), 1989; Terrero, 1994; Centro de Estudios sobre la Economfa Cubana, 1995; ECLAC, 1994.

^a Estimate.

^b Figures in brackets indicate months.

The fiscal measures designed to reduce expenditures and increase revenues included the following:

- a reduction in subsidies to enterprises from an actual level of 5.4 billion pesos in 1993 to a budgeted level of 2.2 billion pesos in 1995, through the authorization of higher prices and stringent measures to promote self-financing;
- price increases for some items, such as cigarettes, cigars and rum;
- increased charges for services such as electricity, telephones, transportation and postal services;
- introduction of charges and elimination of subsidies for workers' dining rooms, school lunches, vitamin supplements and foreign language courses;
- charging of entry fees for sports events, museums and art galleries;
- increases in the charges in U.S. dollars collected from foreigners for such services as telephones, electricity, postal services and the use of airport facilities;
- increases in prices in all dollar stores;
- taxation for self-employed workers (through registration fees at first);
- income taxes for citizens earning foreign currencies;
- probable increases in tariffs on some imported items such as donated vehicles (a tariff of 100% in old pesos on the basis of the U.S. dollar price);
- reductions in some components of public expenditure prior to 1995 (details not yet available).

By helping to reduce the fiscal deficit that subsequently has to be financed by the creation of money, all these measures help to ease the bifurcation.

2. Reform measures

Initially, there appears to have been a paralysis in public policy making which lasted from 1990 to mid-1993. Although the economy was contracting seriously in these years, no significant reform policies were introduced (the National Food Programme, presented in the National Assembly in December 1990, was essentially an old-style "campaign" involving more intensive planning for the reallocation of resources to agriculture. Its results were minimal, partly because the national economic contraction

prevented the large infusion of imports and resources which the Programme required). As the contraction continued, however, a do-nothing approach by the government became increasingly indefensible. Meanwhile, citizens were improvising their own survival strategies to cope with the difficult circumstances they were facing. These strategies usually involved economic initiatives outside the formal planning system and the traditional socialist economy, and these initiatives mostly involved "chasing dollars" in the internationalized part of the economy, various types of "rent-seeking" between the traditional socialist and internationalized parts of the economy or through black market transactions of various sorts, or the provision of goods and services in the underground market economy.

The reform measures introduced after mid-1993 mostly legitimized the economic activities which Cubans themselves had undertaken as they tried to improvise their own survival strategies. The reforms were essentially official responses to the grass-roots behaviour and pressures of Cuban citizens in a situation in which there appeared to be no other public policy options that were reasonable, credible or viable. The reform measures have strengthened the internationalized part of the economy and have permitted the emergence of what might be considered a third component of the economic structure, though it is closely related to the internationalized part. This third component is the domestically-oriented peso/dollar market economy which has resurfaced since the introduction of the reform measures and has grown rapidly since the new laws were passed.

The first major reform measure to be introduced following the period of policy paralysis was the decriminalization of the holding and use of U.S. dollars by Cubans, in August 1993. This measure gave official recognition and legitimacy to what many Cubans were already doing. However, the measure also increased the use of the dollar in normal day-to-day transactions because of the elimination of the fear of prosecution, which had been a major concern and impediment to the use of the dollar prior to this. The legalization of the use of the dollar and the consequent increase in the demand for dollars for transactions and "nest egg" purposes probably contributed to the initial rapid appreciation of this currency from mid-1993 to mid-1994. At all events, this measure strengthened the dollar-oriented economy and the use of the dollar for domestic transactions.

The liberalization of self-employment in micro-enterprises in September 1993 permitted people in 147 types of economic activity to officially register and function legally and "above ground" (Gobierno de Cuba, 1994a). By late 1994, some 170 000 persons had registered as self-employed, with over 48 000 in Havana alone (*Granma*, 1995, p. 3). The expansion of this sector provided a growing outlet for the excess money incomes. As it expands, prices may be driven down further, although this also depends on the rate of money creation, which in turn depends largely on the fiscal deficit. Of particular significance for the expansion of the market mechanism was the re-establishment of agricultural markets on 1 October 1995. The legislation in this connection explicitly states that prices in these markets are to be determined by supply and demand; that all types of agricultural producers are eligible to use them (including private farms, State farms, UBPCS, army farms, backyard gardeners, and various other types of cooperatives); that the whole of Cuba is to be an integrated market with freedom to transport agricultural products to anywhere on the Island; but that farms can sell in these markets only after their contracts with the State have been fulfilled.

A related law of 7 October 1994 liberalized transportation by authorizing any owner of transport facilities such as trucks to contract directly with farms to move foodstuffs to market (Ministerio de Transporte, 1994). These two laws had a variety of beneficial effects quite quickly. In the last three months of 1994, an estimated 20% of total food suppliers were going through these markets, and some estimates were even higher (*Granma Internacional*, 1994). Thanks to these, food availability in urban areas increased and food prices sank well below the

black market levels. They provide incentives for all farms to expand their production in coming crop years, so that supplies should increase and prices fall still further. The subsequent legalization of industrial and artisanal markets (1 December 1994) was modelled closely on the measures governing agricultural markets. The growth and impact of these markets so far have been less dramatic than in the case of the agricultural markets, but generally speaking these markets appear to have a considerable variety of manufactured products such as kerosene stoves, aluminum kitchen utensils, shoes and clothing, all aimed at the domestic market. Craft workers and artists are producing a remarkable and rapidly expanding variety of items not only for the tourist market but also increasingly for the large numbers of Cubans who have access to dollars.

In short, the legalization of self-employment, the establishment of agricultural, transport, industrial and artisanal markets, and the conversion of State farms to cooperatives has increased the role of the price mechanism and the scope of the market economy. This part of the economy, though closely related to the internationalized dollar-oriented economy, is somewhat distinct in that it is more domestically-oriented (though not totally), and it is more peso-based (though again not totally). This marketized part of the Cuban economy represents, in part, a fusion of the internationalized dollar-oriented and the traditional socialist part of the economy. Indeed, the movement towards a mixed market economy must necessarily involve the steady expansion of this marketized component and the steady convergence of the socialist economy and the internationalized economy towards that component.

V

Reunification, transition and adjustment in the future

A variety of public policy initiatives and institutional changes will ultimately be required for the unification of the two parts of the economy. So far, some important reform measures have been introduced, as discussed in the previous section, but a number of other measures will also be necessary.

1. Enterprise liberalization

The legalization of self-employment in micro-enterprises and the establishment of markets in which they can legally operate was an important positive step, as already noted. However, the evolution of this

sector is still hindered by a number of legal provisions. The limitation on the size of enterprises—which are officially self-employment ventures but in practice are sometimes family enterprises—is particularly restrictive. Many types of economic activity need to be larger if they are to operate effectively and efficiently.

Second, the range of self-employment legalized from September 1993 to July 1995 excludes a broad variety of “high-technology” types of enterprise and restricts the permitted activities to those which are mainly of a “low-tech” character (*Granma*, 1993, p. 5). Business service enterprises in particular—technical consultants, management consultants, computer firms, accountants, law offices, marketing firms, surveying firms, office services, architects, geological exploration, etc.—can all provide important inputs to public and private sector firms in a cost-effective manner and they need to be legalized if Cuba is to develop a sophisticated modern economy. This also means that university graduates, with the continuing exception of medical personnel, should be permitted to enter these new types of self-employment. A variety of personal services and some small-scale manufacturing could be usefully legalized as well.

Third, the legislation for microenterprises prohibits private retailing, which dooms the sector to continued low-level operation, as each producer must also be the retailer. Stores which would bring together a range of products and varieties of products are thus effectively blocked.

Fourth, it would be beneficial if property legislation were modified to permit retailers and producers to re-establish stores and specialized shopping areas. Is it reasonable to confine sales of agricultural, artisanal or industrial products to specific market sites, some of which are already quite overcrowded? The liberalization of the rules on the location and rental arrangements for such enterprises would be very useful for improving the quality of many types of services to the public.

In short, the removal of a number of restrictions on the development of this sector could generate employment, improve the material quality of life for Cuban citizens, and improve the productivity of large-scale public or private enterprises through the provision of business services. All of these are priority concerns at present. Lifting the limitations on the development of this sector would also permit the acceleration of entrepreneurial learning in the area of small enterprise management: a learning process

which has been blocked since the 1960s but which will be of vital importance when Cuba normalizes its relationship with the United States (and experiences a major inflow of Cuban-American financial, technological, managerial and entrepreneurial expertise).

Finally, easing the restrictions on the development of micro-enterprises is also vital as a means of increasing the demand for pesos and the supply of goods and services available for the public, which would put downward pressure on market-determined price levels and on the black market exchange rate for the U.S. dollar.

2. Institutional changes

In the process of transition to an “economy with the market” a wide variety of institutional changes will be necessary, some of which will play an important part in the reunification of the traditional socialist peso-based and internationalized dollar-based parts of the economy. The most important changes of this sort, apart from enterprise liberalization, which has already been discussed, will perhaps be the establishment of markets for housing, cars and other physical assets, privatization and cooperativization, and the redesigning of the “Sociedades Anónimas”. Other institutional changes, such as reform of the financial and banking system, the establishment of a regulatory framework for the functioning of the private sector, and the redrafting of property legislation, for example, are important for an economic transition, but perhaps less central to the issue of the unification of the economy.

The legalization of markets for housing and other physical assets would be a useful step in itself, as well as its effect in increasing the demand for pesos and helping to reduce the black market exchange rate and other market-determined prices. At present, people must either sell their homes, at a price expressed in old pesos, to the State, which then allots housing on the basis of political criteria, or else people can exchange their homes in return for the unofficial transfer of a suitable amount of cash, so that a market of sorts could be said to be functioning already (most people in Cuba, perhaps 80%, own their homes, but lack the right to sell or to buy homes at market-determined prices). If a true market for housing were established, house prices would rise significantly and a new and important use and demand for old pesos would occur, the end result being

downward pressure on the black market exchange rate and a reduction of the structural split in the economy. Legalization of markets for other physical assets would have a similar result.

A second institutional reform which has considerable potential but which would have to be managed carefully would be a process of privatization or co-operativization of existing State-owned assets. This has already been undertaken with a large proportion of State farms and their conversion to cooperatives. There are many State-sector service facilities which operate on a small scale and which already face effective competition from an expanding self-employment sector. Such businesses include State retail shops of various kinds, repair shops, personal services such as beauty parlours or barber shops, small bars, and coffee shops. Privatization of such facilities by their sale to Cuban citizens would make good sense in terms of the quality of the services which would be provided, since State ownership has been least successful in ensuring quality and in adapting to consumer demand in the area of small-scale services. Privatization would also allow the State to acquire significant amounts of old pesos, thereby reducing their supply, driving up their value *vis-à-vis* the U.S. dollar and helping to put more downward pressure on prices of goods and services in old pesos. The revenues acquired by the State would make possible a reduction in the fiscal deficit and reduced monetary emission, all of which would be beneficial for reducing the split between the socialist and internationalized economies.

Privatization of medium- and large-scale enterprises is more controversial and more difficult. The Cuban government is already permitting partial privatizations to foreigners through the establishment of minority foreign ownership of joint ventures, often but not always for new investment projects. Privatization of existing assets to foreigners, even through joint ventures, has its drawbacks, namely the disposal at fire-sale prices of valuable assets and the stream of profits which will be expatriated by the foreign owners in the future. Privatization to Cuban citizens might be more advantageous, but Cuban citizens could not pay U.S. dollars for such assets. Other formulas such as the co-operativization of some of the larger assets to Cuban citizens would be worth exploring, however. Privatization or partial privatization of natural monopolies (such as the sale of 49% of the telephone system to the Mexican firm Domus)

is even more difficult and requires the creation of new public regulatory institutions to prevent the possible abuse of monopoly power.

3. Macroeconomic policy

Cuba's macroeconomic policies, including fiscal, monetary, exchange rate and price control policies, have been of central importance in generating the structural bifurcation of the economy. These complex and contentious policy issues cannot be analysed in depth here. Consequently, only a few comments are put forward to suggest the combinations and designs of policies that are now necessary to heal the bifurcation and to place the macroeconomy on a stable and sustainable trajectory.

The macroeconomic policies introduced so far to deal with the current situation include the fiscal policy outlined in section IV above and the introduction of the "convertible peso." Fiscal policy has been aimed at increasing tax revenues, reducing expenditures, cutting the fiscal deficit and thus reducing the creation of money for financing the deficit and the consequent inflationary pressures. On the basis of the information available so far, it appears that fiscal policy has been quite successful in achieving its objectives: the fiscal deficit has been cut sharply, monetary emission has slowed, and indeed the black market exchange rate and market-determined prices have declined since the tough fiscal measures were introduced (though for other reasons as well). However, the deficit projections for 1995 remained relatively high at around 5 or 6% of GDP (*Granma Internacional*, 1995, p. 4), so that inflationary pressures will continue as long as the deficit can be covered only by creating money, in the absence of a domestic bond market.

The creation and emission of the "convertible peso," introduced in December 1994, is part of a general strategy to replace the "old peso" with one which is convertible, presumably at par, with the U.S. dollar (the well-printed "convertible peso" does not state what it is convertible into, nor at what exchange rate). There is little hope that the convertible peso can become much more than a marginally-utilized currency, and no hope that it can absorb the old peso system and also maintain parity with the U.S. dollar. The Central Bank was able to maintain convertibility of the new peso with the dollar at least up to August 1995, but only because it had been introduced barely

7 months before. It will be difficult to keep the volume issued down to a level which can maintain convertibility with the dollar, for the resources thus acquired at no cost by the government through seigniorage are too attractive to turn down. I would estimate that by early 1996, if not before, the volume of new convertible pesos emitted will be too high to permit their full and immediate redemption for real goods and services in the dollar stores. When this happens, the psychological acceptance of the convertible peso as being as good as the dollar will cease, and people will be unwilling to hold it for store-of-value purposes, preferring the dollar. When that happens, the convertible peso will cease to have the same value as the dollar in the unofficial currency market and it will suffer devaluation *vis-à-vis* the dollar. Cuba will then have a three-currency system with a whole range of new complexities and problems.

What macroeconomic policies could be adopted in order to unify the structure of the economy and improve stability? The following summary of policies is presented as an illustration of the types of policies which need to be analysed, rather than as a set of concrete proposals.

a) Fiscal policy

- Fiscal policy aimed at deficit reduction has already begun to be applied, with fairly satisfactory results;
- Further tax increases and/or expenditure reductions are needed to lower the deficit to a sustainable level;
- Alternatives to money financing of the deficit –e.g., bond sales to the public– could be developed;
- Conversion of the current non-tariff barriers into regular tariffs could be a fruitful revenue source over a transitional period;
- State enterprises should set their prices so as to cover their costs as a necessary part of deficit reduction.

b) Monetary policy

- Reductions in the rate of emission of “old pesos” are urgently needed for continued anti-inflation purposes;
- Emission of the new “convertible peso” should be very small and aimed only at capturing some “seigniorage” for the government instead of allowing the U.S. dollar to enjoy this benefit;
- Other types of measures are needed to increase the demand for the “old peso” and put downward pressure on prices and the black market

exchange rate. Such measures could include the establishment of genuine markets for housing, cars and other assets; enterprise liberalization as discussed earlier, and general expansion of the role of the market;

- Reduction of the supply of old pesos and measures for increasing the demand for them, so as to lower market-determined prices and the black market exchange rate.

c) Exchange rate policy

- Maintenance of the convertibility of the “new peso” at par, by strictly limiting its emission;
- Promotion of actions to increase the use and value of the old peso *vis-à-vis* the dollar in the black market: i.e., to increase the demand for the old peso;
- Unification of the exchange rate immediately, but at the tourist rate level (i.e., all commercial transactions should be carried out at US\$1 = 1 peso rather than US\$1 = 0.74 peso) (the first step should thus be taken in the devaluation process);
- A process of devaluation of the old peso should be begun;
- Measures should be taken aimed at the elimination in 3 or 4 years of the spread between the official and the market-determined exchange rate;
- The “convertible” peso and the old peso should be unified when the official and market-determined rates merge.

d) Protectionism

- Most or all of the discrimination in the implementation of (bureaucratic discretionary) protectionism should be gradually eliminated through the ending of the “zero tariff/no NTB” privileges of the “Sociedades Anónimas”; the standardization of tariff rates for all sectors (perhaps with special treatment initially for pharmaceuticals and some foodstuffs), and the replacement of non-tariff barriers with tariffs;
- The adjustment process should begin with high tariff levels (for balance of payments and revenue-raising purposes), to be steadily lowered as the external sector improves and the economy recovers.

e) Policies on prices and social security

- Price controls should be phased out quickly wherever they do not affect the cost of the basic set of rationed foodstuffs available;

- The prices of non-food rationed goods should be progressively raised, with the ultimate objective of price decontrol;
- Measures should be taken to move towards a system of income support for needy individuals or families rather than comprehensive untargeted general subsidization of everybody through the rationing system;
- The establishment of a targeted, income-support-oriented social security system should be coordinated with price increases and price decontrols for goods currently rationed (e.g., subsidies currently going to loss-making enterprises producing fixed-price rationed goods should be diverted to provide income support payments for the most vulnerable groups).

In my view, the types of policies listed above are necessary for the unification of the bifurcated economic structure as well as for structural adjustment and ultimate economic recovery. Exchange rate and commercial policy are particularly important from the standpoint of expanding and diversifying exports as well as developing domestic substitutes for goods previously imported. A devaluation of the currently

grossly overvalued exchange rate and the reduction (and eventual elimination) of the extreme discrimination inherent in the current system of protection is vital and urgent if Cuba is to break the tight foreign exchange constraints on its economic recovery. A combination of a continuing tight fiscal policy and an innovative but anti-inflationary monetary policy could assist in increasing the use and demand for the old peso while constraining the increase in its supply. The result of this would be to reduce the black market exchange rate in relative terms, while market-determined prices would probably go down from current levels, thereby also reducing the incentives for resource shifts between the traditional socialist and internationalized sectors to more appropriate levels. It is also very important to modify the social security system to protect those who are hurt by the various policy changes (particularly in price policy), through income support payments rather than the present generalized subsidies to everyone via fixed-price rationed goods. It may be noted that the need for reform of the social security system has already been expressed by the Cuban Minister of Finance, Dr. José Luis Rodríguez (A. Rodríguez Drivet, 1995.)

VI

Summary and conclusions

This essay has analysed the central structural feature of Cuba's economy in the first half of the 1990s, namely, the split between the traditional socialist peso-based component and the internationalized dollar-oriented and marketized component. The origins of this bifurcation lie in i) the rapid expansion of tourism, foreign business (within joint ventures) and the "Sociedad Anónima" conglomerates; ii) pre-1994 macroeconomic policies which produced large fiscal deficits, accelerating expansion of the money supply, rapid inflation in market-determined prices, and extreme devaluation of the old peso *vis-à-vis* the U.S. dollar in unofficial currency markets, while the official rate remained fixed; iii) exchange rate policy and commercial policy which produced extreme discrimination in access to imports, favouring the internationalized sector (especially the "Sociedades Anónimas"), and iv) the general weakness, loss of confidence and contraction of the traditional socialist economy.

This dual currency bifurcation of the Cuban economy has important consequences for the functioning of the economy and society. First, there has been a major impact on income distribution, as those Cubans who have access to U.S. dollars receive considerably higher real incomes, due to the high value of the dollar in unofficial exchange markets, relative to persons working in the traditional socialist economy with incomes in old pesos. This income differential creates an overpowering and universal incentive for resources –most obviously human resources– to be attracted to the internationalized part of the economy. While some reallocation of resources to the foreign-exchange-earning part of the economy is reasonable, the internationalized component is not identical with those activities which earn foreign exchange (e.g., sugar and tobacco) or which produce potential substitutes for imports. The real rewards which society provides to those able to earn or

acquire dollars appear to be out of line with the real value of their contributions to the economy or society. Moreover, this split contributes to pervasive "rent-seeking", as individuals can earn more by arbitraging goods and services across the two economies, playing the differences between fixed and market-determined prices and the official and unofficial exchange rate. Several negative social phenomena have also been worsened by this bifurcation.

A number of public policies introduced since mid-1993 have tended to reduce this bifurcation. The legalization of self-employment and the establishment of agricultural, industrial, artisanal and transport markets have permitted an expansion of the market economy which is in part linked to the internationalized dollar-oriented economy in that market forces determine prices and incomes for the participants. Since 1994, fiscal policy has been quite effective in slowing the process of bifurcation.

A broader array of policies and institutional reforms are required for unification of the economy. Of particular significance would be further liberalization of small- and medium-scale enterprise and certain institutional reforms such as the legalization of markets for housing, continued cooperativization where appropriate, and privatization of small- and medium-scale enterprises of various sorts (especially in retailing and other services). These measures would expand the market economy and would have beneficial macroeconomic effects which could be of major significance in lowering the black market exchange rate and helping move the economy towards a more appropriate general structure of incentives. The area of greatest importance, however, is macroeconomic policy (continued reduction of the fiscal deficit and reduced money creation) plus appropriate exchange rate and commercial policies, all designed to unify the black market and official exchange rates (at perhaps 3 pesos per U.S. dollar?) and to standardize the

system of protection, while eliminating the strong discrimination inherent in its functioning at present. Price decontrol would also be part of such a package of policies, but this would have to be accompanied by the conversion of the current social security system from one of generalized subsidization of everyone (through price controls on rationed commodities) to one of carefully targeted income support measures for those really in need of such assistance.

This broader array of institutional and macroeconomic measures would also provide many of the policy changes needed for successful structural adjustment. The devaluation of the official exchange rate (plus the merging of the unofficial and official rates), together with further liberalization of small- and medium-scale enterprise, standardization of commercial policy and the elimination of discrimination in its application, should permit major expansion and diversification of production for domestic and foreign markets. Such expansion of production for export and for substitution of imports is vital if Cuba's economic recovery is to be sustained and sustainable into the future.

Cuba has only just begun the process of policy and institutional reform needed for the achievement of adjustment, transition and recovery. While the government's caution in the design and implementation of policy changes is laudable, its hesitation to move in a determined manner in a variety of policy areas in the December 1994 to August 1995 period is unfortunate. One cannot help but be awed by the immensity of the task of achieving economic recovery in the context of the extreme deterioration of the capital stock in most areas of infrastructure as well as in industry, agriculture and services, where the existing facilities are environmentally unfriendly, energy-inefficient, internationally uncompetitive and basically obsolete.

(Original: English)

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