

Chapter 2

“Cuban Economic Policy under the Raúl Castro Government”

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Abstract

In the first two years of the Raul Castro's elective period (2008-2009), the economic policy confronted the downturn of the GDP growth. The economic boom that began in 2004 was stopped by several negative shocks— among them, the global crisis - that made visible the structural weaknesses of the growth and brought out previous mistakes of the economic policy. In 2008 the economy experienced significant external and internal imbalances. In 2009 the economic policy carried out an adjustment that allowed restoring to a great extent the balances, but it could not avoid the banking crisis. The economic policy, under Raul Castro's commandment, has been effective from the expenditure side, which is an important step to recapture credibility and financial stability. Nevertheless, there are few measures to encourage incomes and it is questionable to keep a policy of fixed exchange rate. Without a lender of last resort, viable alternatives are not visible for a solution in the short term of the current financial crisis. Therefore, a high probability remains for the Cuban economy to submerge in a stagnation or recession period, inevitable at this point for the economic policy.

Key Words: Cuba, Latin America, global crisis, Raul Castro, economic policy, banking crisis.

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1. Introduction

On February 24, 2008, Raul Castro officially assumed as the president of the Council of State and Ministers of Cuba in replacement of his brother Fidel Castro. Since 2004 the Cuban economy had experienced a boom of the economic cycle with exports expansion, the increase of the Gross Domestic Product and fiscal income, and a light improvement of the real salary, keeping price stability and low unemployment. During the first two years of Raul Castro's elective period (2008-2009), the economic policy faced the abrupt reversion of this cycle stopped by several unfavorable shocks – among them the global crisis - that made visible the structural weaknesses of the economic growth and made evident the mistakes of the previous economic policy.

Raul Castro receives also an economy with multiple shortcomings and distortions inherited from the internal crisis of the early nineties and the persistence of a state centralized economic model. On July 26, 2007, when he was still exercising temporarily the presidency, Raul Castro promised “structural and conceptual transformations” in the economy (Castro 2007). In several occasions he has expressed his willingness to solve the agricultural sector problems, to eliminate the monetary duality, to increase the still very low wage level, to reinforce the institutionalization of the economic system, to eliminate subsidies, to impel labor productivity, among other goals. After the first two years in charge, he has targeted some structural changes and a major group of institutional modifications, but still below the expectations and with a slow rhythm of implementation. Answering to this critical points of view Raul expressed at the end of 2009: "I have conscience of the expectations and honest preoccupations, expressed by the deputies and the citizens as for the speed and depth of the changes that we have to introduce in the functioning of the economy “; and he added that “... in the update of the Cuban economic model, in what we are working with an integral approach, there cannot be space to the risks of the improvisation and the hurry. It is necessary to walk towards the future, with firm and sure step, because simply we do not have right to be wrong” (Castro 2009).

The Cuban economy has had to keep developing in an environment extremely complicated, since despite some measurements of flexibility of the Barack Obama's administration, the economic blockade persists with expensive consequences.

In 2008 the economy experienced significant external and internal imbalances. In 2009 the economic policy carried out an adjustment that allowed restoring to a great extent the balances, but could not avoid the consequences on the financial system. The principal challenge that the economic policy faces

nowadays, is the Cuban banking crisis, which is affecting the external and internal commerce, worsening the weak financial position of the country, feeds new imbalances and threatens to provoke the biggest economic crisis of the island since the disappearance of the Soviet Union.

The main goal of this article is to evaluate the economic policy under Raul Castro's commandment in the period 2008-2009. In order to accomplish this goal, the following sections are structured. In section 2, the macroeconomic situation is summarized and compared to tendencies during the decade of the Gross Domestic Product, the external sector, and wages and employment. Section 3 is dedicated to fiscal policy; the causes of the fiscal imbalance in 2008 are explained, the actions to reduce it in 2009 and the new adjusted budget for 2010. Section 4 deals with monetary policy; in addition to evaluating the inflation, the money supply and the exchange rates; the characteristics, costs, and possible future of the monetary duplicity of the Cuban peso and the convertible peso are commented, as well as, the changes that Raul Castro has implemented in the mechanisms for foreign exchange control and centralization. Section 5 is dedicated to explaining the banking crisis, its determinants and implications. Section 6 does a summary of the institutional changes accomplished by Raul Castro and section 7 explains the structural transformations. Sections are not independent; they try to analyze into the transmission channels of different policies, for finally, in the section 8 appraise summarily the outcomes of the measures taken during this period and its fundamental challenges.

This analysis has data limitations. Some of the evaluated topics are very new and others would require a more detailed empirical examination. Nevertheless, an effort has been made to compile the most updated data, compare it with the tendencies of the decade, and Raul Castro's own speeches are used as reference of the emphasis and intentions of the economic policy. In order to facilitate the comprehension of readers not familiar with the Cuban economy, some essential explanations are made about the Cuban economic model and complementary references are recommended.

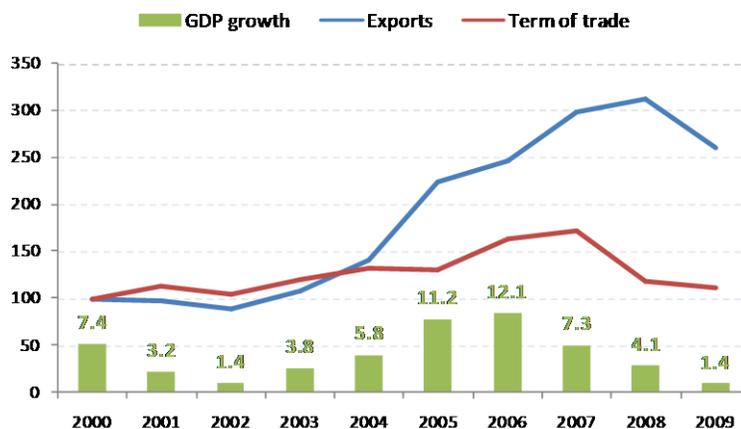
2. Macroeconomics

Compared to the period 2001-2003 of lower economic growth, from the year 2004 the Cuban real Gross Domestic Product (GDP) accelerated itself and reached in 2005 and 2006 growth rate of 11.2% and 12.1%. From 2007 began a tendency to the deceleration until 2009 in which a growth of 1.4% is

obtained. The terms of trade and exports of goods and services contributed significantly with the expansion of the economy from 2004 by relaxing the external constraints (Graph 1).²

Graph 1. Real GDP, current exports of goods and services and term of trade, 2000-2009.

(index 2000=100. GDP in percentage variation, right axis)



Source: Elaborated by the author based upon the Cuban National Statistic Office data, (ONE) (2008 and 2009a)

The exports increase is explained principally by the new agreements with Venezuela, especially, the exportation of medical services that annually contribute about 6 billion dollars, three times the tourism contribution. The exports of medical services is part of a wider project of regional integration known like ALBA (Bolivarian Alliance for the Peoples of Our America), integrated by Venezuela, Ecuador, Bolivia, Nicaragua and some Caribbean islands, among them Cuba.³

The slowdown of the GDP from 2007 to 2009 can be explained by four fundamental factors:

- The exports of Cuban medical services and other services had an initial boom in 2004 along with the appearance of a new market in Venezuela guaranteed by governmental bilateral

² Various authors have empirically verified in the Cuban case, the relationship between the economic growth and the external sector, proper of a small open economy. Some of them are Moreno-Brid (2000), Mendoza and Robert (2002), Alonso and Sánchez-Egozcue (2005) and Vidal and Fundora (2008).

³ The increment of the external income to the Island allowed to impulse a huge investment process organized by Fidel Castro, known as the *Battle of Ideas* emphasizing the development of health, education and transformation on the production and consumption of energy, known as the *Energetic Revolution*. For an examination of the Cuban economy during the period of time 2000-2006 see Dominguez, Pérez and Barberia (2007) and Pérez (2006).

agreements. Nevertheless, the potential level of Cuban exports to Venezuela seemed to be stagnated in few years, over all, after covering the limited amount of health personnel the island could afford without affecting its inner health system. At the same time, other sectors as the industry and the agriculture were remaining stragglers, partly, for the low multiplier effect of the professional services exports. The sector of the professional services has few linkages with the internal economy, in contrast to what was happening with the sugar agroindustry and tourism, engines of the Cuban economic growth in previous decades.⁴ Another structural weakness of the growth is that it was accompanied for an augment of the external dependency; Vidal and Fundora (2008) estimates an increase of the income elasticity of demand for imports from 2003; for 2005 they estimate an elasticity of 3.06.

- In 2008 the Cuban economy suffered an abrupt fall of the terms of trade, repeated on minor scale in 2009 (Graph 1). The terms of trade fell down 31.6% in 2008 and 5.8% in 2009. The main cause was the collapse of the nickel price —Cuban principal export product—in parallel with the international increase of the oil and food prices— major imports items.
- Another shock came during the year 2008 with the simultaneity of three hurricanes, affecting mainly housing and food production that, as a whole, summarized an estimated cost of 9.7 billion dollars.
- Finally, the global crisis arrives in 2009 to complicate even more the macroeconomic performance. The fundamental transmission mechanism of the global crisis to the Cuban economy occurred through exports. In 2009 current exports of goods and services collapsed by 16.6% after 6 consecutive years of growth (Graph 1). The fall of the Venezuelan GDP, first commercial partner of the island, had a repercussion on demand for Cuban exports.

⁴ Sánchez-Egozcue and Triana (2008) have the opinion that if on one hand “Cuba should not repeat historic mistakes making its economy dependent on one sector and on one country”, on the other hand there is the possibility that along with medical services, the Island develops “the exports of medical equipments, generic and biotechnological medication, investment on other countries on biotechnology along with transferring technology”. They add that on achieving these Cuba will be in presence of one of the “most dynamic sectors of the national economy with height possibilities of generating synergies with potential positive effects in the near future on the remaining sector of the national economy.”

The Cuban economy received the global crisis in a weak macroeconomic situation. The structural fragilities of the economic growth and two external shocks, previous to the international crisis, already had eroding effects on the economy of the island.

In spite of the world crisis and the average fall of the Latin America and the Caribbean economies in 1.7%, the Cuban GDP keeps a positive variation in 2009. The measurement of the Cuban GDP, with a high weight on services, prevented a negative record. The growth of 1.4% of the GDP in 2009 decomposes in an increase of the *basic services* of 1.2% and an increase of *other services* on the order of 4.0%, whereas the production of goods decreases 3.6%. The *basic services* represent 39.5% of the entire GDP value at constant prices and it includes commerce, transport, communications, hotels, electricity, water, etc. The component of *other services* represents 41.3%, out of which the health services are 17.5% and education 8.1% (ONE 2009a). The Ministry of Economics and Planning's projection for the year 2010 is a growth of 1.9% of the real GDP, with which, the extension of the stagnation is officially recognized but a recession is not on the forecast.⁵

The Cuban balance of payments, from 2004 to 2007, was equally favored with the expansion of the exports. The imports rose with a positive balance in the goods and services trade; it is significant the surplus of 1232 million dollars in 2005 and of 1712 million dollars in 2007.⁶ In 2008 the balance completely changed, the current imports grew more than the exports and there was a deficit of 2484 million dollars. In 2009, the trade balance had a surplus, but in this occasion through severe imports adjustment (Graph 2).

The current imports growth in 2008 scaled up to 43.3%, due principally to the shocks mentioned above; the international increase of oil and food prices and the additional imports needed to cover the costs of the hurricanes. In 2009, the economic policy under Raul Castro's management assumed a rigorous adjustment of imports (-37.3%) including two reviews of the central plan during the year, a strong policy of energy saving, the investments contraction (-16%) and control of the fiscal spending (0.8%); all this with a discretionary and centralized character, without using price incentives and sustaining a fixed exchange rate policy.

In December 2008, the president Raul Castro stressed that "Our elemental duty is to fit the expenses in foreign exchange to the volumes that we are in conditions to obtain ... In addition to that imperious

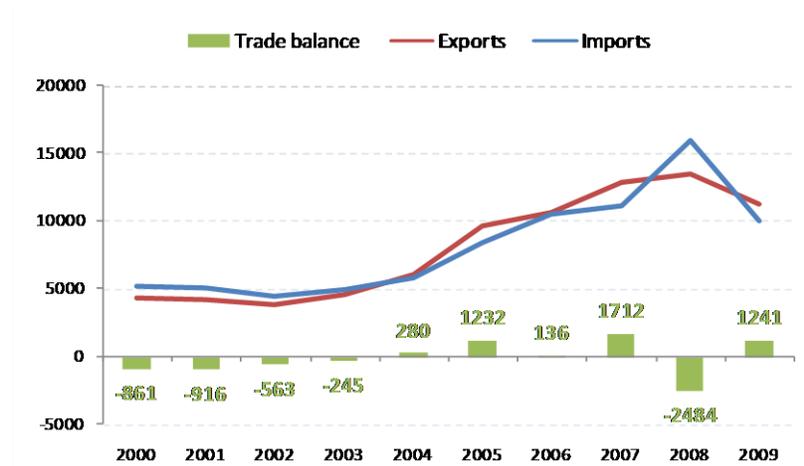
⁵ The official forecast for the GDP growth in 2009 had been 6%, thereafter reduced to 2.5% with the first revision of the central plan and finally of 1.7% on the second revision.

⁶ The trade balance of goods remained negative and deteriorated in 2004-2007.

necessity; it constitutes an elemental duty toward the future generations. It would not be ethical to increase the non-productive expenditure at the cost of contracting debts that our children and grandchildren would have to pay” (Castro 2008b).

Graph 2. Exports and Imports of Goods and Services, and Trade Balance, 2000-2009.

(In million of American dollars)



Source: Elaborated by the author based upon the Cuban National Statistic Office data, ONE (2008 and 2009a)

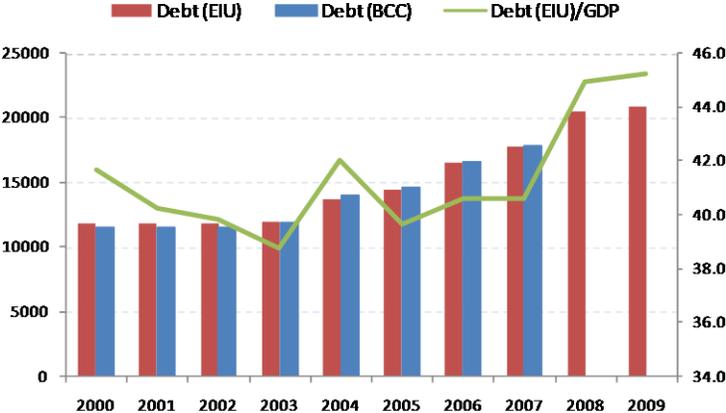
The last data of external debt reported in 2007 by the Central Bank of Cuba was 17820 million of American dollars; of which, 8199 million correspond to the debt that has not been restructured since 1986; and 60.2% to the official debt belonging to creditors of the Paris Club (Central Bank of Cuba, 2008). Economist Intelligence Unit (EIU), which only has had some small differences with the annual value reported by the Cuban Central Bank, estimated a significant increase of the external debt in 2008 (15%) and a slight increase in 2009 (2%). According to the EIU (2009) estimations, in 2008 the external debt as ratio of GDP deteriorated up to 44.9% and in 2009 up to 45.2% (Graph 3).

The external debt had been rising from 2004, but the accelerated growth of the GDP kept the ratio of external solvency controlled. The problem of solvency showed up as soon as the growth of the GDP was not sustainable and also in 2008 took place the negative shock of terms of trade and the hurricanes that increased the imports and forced the government to augment more its external debt to finance the trade imbalance. By mid 2008, the first consequences of the solvency deterioration surfaced, when the

country could not honor its financial commitments with creditors in Japan, Germany, Canada and France. In 2009, the external debt growth stopped, first, because of the government adjustment, and second because of biggest difficulties obtaining foreign financing in the middle of the global crisis and the visible deterioration of the external solvency of the country.

Graph 3. External Debt Ratio of External Solvency (External Debt /GDP), 2000-2009.

*(In million dollars, left axis. Ratio of solvency in percentage, right axis)
 (EIU: Economist Intelligence Unit. BCC: Central Bank of Cuba)*



Source: Elaborated by the author based upon the Central Bank of Cuba (2008) data and Economist Intelligence Unit (EIU) (2009)

The deterioration of the macroeconomic conditions in 2008 and 2009 had, up to the moment, no implications for real wage and employment (Graph 4). The average real wage had a positive tendency in the decade favored by low inflation rate and centralized raises of the levels of nominal wage. From 2005 the government made consecutive increases of the minimal wage and centralized raises of the wage scales in enterprises and state institutions. Nevertheless, the wage purchasing power in the state sector is far from recovering from the crisis of the beginning of the nineties and remains damaged by low labor productivity in almost all sectors.⁷ In 2009, the wage purchasing power was equivalent to 26.6% of the pre-crisis level in 1989. This is one of the mayors problems facing the Cuban economy, and cause of

⁷ See Torres (2008) for a labor productivity analysis in Cuba.

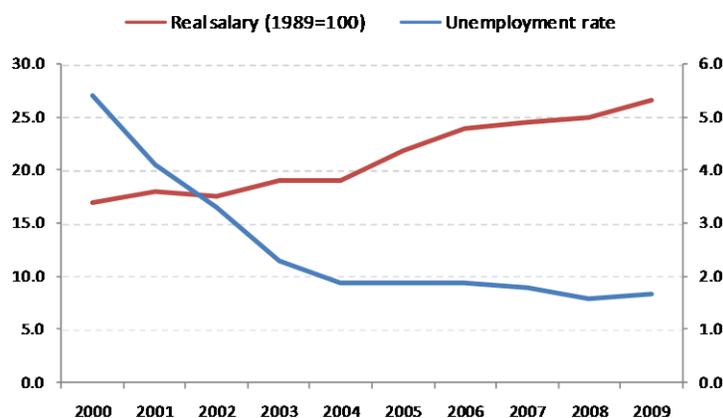
emigration of the qualified workforce, illegalities, work disincentive, inequality, among others distortions.⁸

Mesa-Lago (2008b) estimates that the real pension has continued a trajectory similar to the wage; in 2007 it was a 61% lower than in 1989. The wage and pensions affectations have not pushed the Cuban family into misery thanks to important social expenses and widespread subsidies, among them the ration card (or supply notebook); a system by means of which the state monthly assigns to all individuals a basic basket —principally food—at a very subsidized prices.

The unemployment rate also continued a favorable evolution in the decade. From 2004 it is below 2% (Graph 4). From official numbers, Mesa-Lago (2009) estimates that 6% of the economically-active population does not look for employment. Within the affecting causes are the low level of real wage, a widespread system of subsidies and the possibility of obtaining major income on the informal market. Also, as parts of the workforce are considered persons who have not already a job and were sent for long periods to study or training. A high percentage of the workforce is under the condition of underemployment, with pernicious implications for labor productivity (Mesa-Lago 2009).

Graph 4. Real salary and unemployment rate, 2000-2009.

(Index 1989=100, left axis. Unemployment rate in percentage, right axis)



Source: Elaborated by the author based upon the Cuban National Statistic Office data, ONE (2009a and 2009b) and Vidal (2007)

⁸ See Espina (2008) for topics like poverty and inequality in Cuba.

3. Fiscal policy

3.1 Fiscal balance

In 2008 the fiscal deficit grew significantly. In 2009 a meritorious adjustment of the deficit was made and a new adjustment is estimated for 2010. The government has launched a campaign of fiscal efficiency that includes a major control and supervision of the budgetary expenses, a reorganization of functions and institutional structures, and the elimination of gratuities and subsidies that would lead to the gradual elimination of the ration card.

2008 had the biggest fiscal deficit of the decade (6.7% of the current GDP) explained by an increase of the expenses and an income fall. Before this date, the fiscal exercise of 2005 had been the worse deficit (4.6%) since the fiscal expenses increased that year from 53% to 63.7% of the GDP. In 2008, impacted by the external shocks, the expenses exceeded 70% of the GDP to reach 73.8% and the income fell down to 67.1% (Graph 5).⁹

In 2009, the fiscal policy managed to reduce the imbalance up to 4.8% of the GDP. This result was back up by better control of fiscal expenses, which scarcely grew 0.42% as proportion of the GDP, whereas, in spite of the economic deceleration, the budget managed to increase its income in 2.3% of the GDP to come to a proportion of 69.4% (Graph 5). The reviews of the economic central plans, the adjustment of the energy spending and the reduction of imports favored the control of the fiscal expense.

For 2010, the fiscal policy proposed itself a new reduction of the deficit up to 3.5% of the GDP. For it, budgeted a reduction of the fiscal expenses in 3.2% of the GDP —from 74.2% in 2009 up to 71% in 2010— to compensate the income fall of 1.9% expected —from 69.4% of the GDP up to 67.5% (Graph 5).

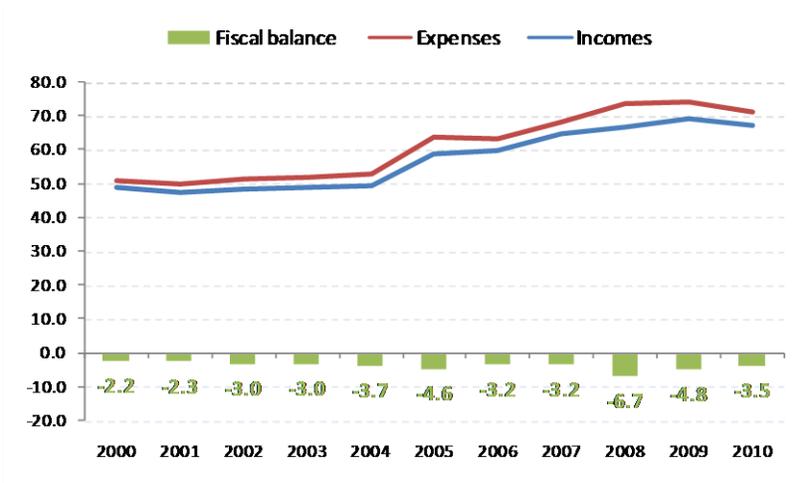
The fiscal adjustment in 2009 and 2010 affects in the short term the growth of the GDP, but contributes to the long-term growth as it promotes price and financial stability. In Cuba an internal market of national public debt does not exist, the fiscal deficit is monetized from the Central Bank; for which, the fiscal disequilibrium have immediate implications on the monetary equilibrium. In addition to pressing the inflation, the expansion of the Cuban peso's monetary base leads to augment the demand for foreign currencies, tensing in such a way the balance of the foreign exchange market. Accordingly, the fiscal policy is forced to preserve the deficit in a monetarily sustainable path without a very wide margin

⁹ Mesa-Lago (2008b) estimates that Cuba has the major social spending of Latin America and recommends transformations for sustainability.

of maneuver for a countercyclical fiscal expansion. As showing, the global crisis surprised Cuba in a weak macroeconomic situation, with a worsening of the external and internal balances and a deterioration of the external solvency, that is to say, without macroeconomic reserves to tackle a countercyclical fiscal policy.

Graph 5. Incomes, expenses and fiscal balance, 2000-2010.

(As percentage of the current GDP)



Source: Elaborated by the author based upon the Cuban National Statistic Office data, ONE (2009a and 2009b)

The official statistics of fiscal deficit allude only to the deficit in Cuban pesos. The fiscal income and fiscal expenses in convertible pesos are taking to the budget in Cuban pesos according to the official exchange rate between them, but the specific data of the deficit or the monetization is not offered in convertible pesos. It is really important since 2003 with the dedollarization of the economy when the government began to have the possibility of getting indebted in convertible pesos. It could be supposed that, although they have different magnitudes, both deficits should continue a similar evolution since it is a question of the same budget. In this sense, the fiscal adjustment in 2009-2010 also is relevant to control the convertible peso’s monetary base, factor that is one of the possible determinants of the banking crisis as will be commented further on.

3.2 Main Fiscal Expenditures and Incomes

In 2008, the budget items that explained the expansion of the expenses were, first of all, the subsidies to enterprises, which grew in an equivalent value to 3.3% of the current GDP, from 10.5% up to 13.8%; it is the principal destination of the fiscal expense, followed by education (12%) that did not increase in 2008. The increase of the subsidy to the state enterprises mainly covered losses occurred during the hurricanes and the ration card prices according to the increase of food prices on the international market. The second biggest growth in 2008 was for health spending (1.6% of the GDP), from a proportion of 9.9% up to 11.5%; the social security followed with a growth of 0.6% (Table 1).

The adjustment of the fiscal expenditures in 2009 was achieved precisely by means of the reduction of the subsidies to enterprises and health spending, the same budget items that had grown more in 2008. As proportion of the current GDP, they represented a contraction of 1.9% and 1.0% that allowed compensating the increase of 2.4% of the education spending in 2009 (Table 1).

A decrease of the budgetary expense in 2010 is estimated, first of all, by means of a contraction of the capital spending in 2.6% (Table 1). It can be explained for a new fiscal policy that reduces the budget participation in enterprises investment activities, and for its replacement, proposes to the state enterprises to use the bank credit.

Table 1. Fiscal Expenditures, 2007-2010.

(As percentage of the current GDP)

	2007	2008	2009	2010
Education	12.1	12.0	14.4	15.5
Health	9.9	11.5	10.5	10.7
Defense and interior order	3.2	3.2	3.4	3.5
Social security	6.4	7.0	7.5	7.7
Administration	1.9	2.3	2.4	2.4
Housing and communal services	2.8	2.7	2.7	2.6
Culture and art	2.0	2.1	2.1	2.1
Science and technology	0.8	0.9	1.0	1.0
Sports	0.9	0.9	1.0	1.1
Social Assistance	2.0	1.5	1.5	1.4
Subsidies to enterprises	10.5	13.8	11.9	11.2
Capital spending	8.3	7.2	7.7	5.1

Source: Elaborated by the author based upon the Cuban National Statistic Office data, (2009a y 2009b)

Another factor of adjustment is the second consecutive reduction of the subsidies to enterprises; in 2008 they were representing 13.8% of the GDP, in 2009 11.9% and budgeted for 2010 a decrease to 11.2% (Table 1). The above mentioned evolution reinforces the intention of eliminating the allocation of subsidies by means of the ration card and reveals a policy of no subsidy to the losses of state enterprises despite the economic slowdown, which marks the difference with the fiscal policy of the beginning of the nineties.¹⁰

Additionally, the budget for 2010 contents a controlled increase of the expenses in health, in scarcely 0.2%, and of the education in 1.1% (Table 1). The education and the health system do not escape the fiscal adjustment. President Raul Castro has pointed out that “We are sure that without affecting the quality of the health and the education system and even improving both of them, free of cost to all the citizens, it is possible to reduce the expenses in a perceptible way” (Castro 2009).

The policy results of major control and fiscal efficiency are appreciated also in other items of the budget. On having compared the 2010 budget with that of 2008, it is appreciated that, as proportion of the current GDP, the variation of the expenses on defense and interior order is 0.3%, administration is 0.1%, housings and communal services -0.1%, culture and art 0.0%, science and technology 0.1% and sports 0.2% (Table 1).

Regarding the fiscal income, Table 2 shows the evolution 2007-2009 and the income estimated for the 2010 budget. In the inserted frame it is described in a summarized way the content of each of the budget items. During the whole period the principal sources of fiscal income have been the *circulation and sales taxes* and *other non-tributary incomes*. The first one has tended to decline and is estimated that in 2010 it will come down to 17.8% of the current GDP from 24.7% in 2007. The second one was increasing until 2008 but also a light contraction is waited for 2010 up to 24% of the GDP, compared to 24.5% in 2009.

Income for *revenue taxes* diminished both in 2008 and in 2009, whereas the *state enterprises contribution* grew in 2008 but fell down in 2009. The income for the *workforce taxes* has been growing at a rhythm of 0.5% as proportion of the GDP, the *personal income taxes* did not grow and the *social security contribution* didn't increase in 2007 and either in 2008 but it did in 2009.

Considering the slowdown of the GDP and the affectations that it produces on the fiscal income associated with the entrepreneurial sector, it is probable that the fiscal policy comes to an extension of

¹⁰ See ECLAC (1997) for the examination of the Cuban fiscal policy during the nineties.

the *personal income taxes*. On his speech in December, 2009 in the National Assembly Raul Castro expressed that it is necessary " the introduction of procedures universally used for the redistribution of the wealth, like the taxes, economic tool to which we will have to get used to in a short period of time." (Castro 2009)

Table 2. Fiscal Income, 2007-2010.

(As percentage of the current GDP)

	2007	2008	2009	2010
Circulation and sales taxes	24.7	21.1	20.4	17.8
Services taxes	2.4	2.3	2.5	2.6
Revenue taxes	5.1	4.7	4.2	4.4
Workforce taxes	5.8	6.3	6.8	7.2
Personal income taxes	0.7	0.7	0.7	0.8
Social security contribution	4.1	4.1	4.4	4.7
State enterprises contribution	4.3	5.2	4.9	5.1
Other non-tributary incomes	14.4	21.2	24.5	24.0

Source: Elaborated by the author based upon the Cuban National Statistic Office data, ONE (2009a y 2009b)

Frame 1. The Items of Fiscal Income.

Circulation and sales taxes: It is a direct income over the commercialized goods to the population in Cuban pesos by the state enterprises. It is a differential price of high collectible yield. It does not tax the goods sold in convertible pesos, neither the supplying notebook. It is applied through a tax rate of 25% and 20% to industrial products and food. Other products like alcoholics and tobacco have major tax rate.

Services taxes: Taxes public services like telephony, electricity, water, transportation, gastronomy, shelter, recreation and others in the national territory. Natural and legal persons are subject to taxation when working on these services. It is applied a tax rate that oscillates from 10% to 30% over the income from these activities.

Revenue taxes: Over all legal persons, nationals and foreigners, no matter what kind of property, dedicated to commercial, industrials, agricultural, financial, services or whatever, with lucrative character. It is applied a tax rate of 35% over net profit.

Workforce taxes: Over the use of the waged workforce and will be paid for legal or natural persons, nationals or foreigners. The taxable base is determined out of the total wage, gratifications and other remunerations that the taxable subjects pay to their workers or employees with a tax rate of 25%. In the specific case of contributors referred to the Low No. 77, about the foreign investment, the tax rate is of 11%.

Personal income taxes: Over the income of natural Cuban persons, no matter from what country they come from, besides the foreigners remaining in the country for more than 180 days. It does not apply to

the whole population but to specific sector including self-employment. Taxation is made in Cuban pesos and convertibles pesos.

Social security contribution: All entities with employees that benefit themselves from the social security system are bind to pay the contribution. The actual tax rate is of 14% and is calculated in base of the wages, salaries and any other way of retribution. In some sector an especial contribution system is established with a tax rate of 5% applied over the received salary.

State enterprises contribution: Besides the taxes over the profit, the state enterprises should give away their Cuban pesos income.

Other non-tributary incomes: Includes trade differential prices from foreign trade, other entrepreneurial contributions and net foreign income.

The future evolution of the fiscal income is compromised by the extension of the economic stagnation; therefore, its potentialities are principally set on the reforms implemented and their impact on the taxable base.

3.3 Fiscal Transformations

The most important fiscal transformation up to the moment is the new Social Security Law, which tries to relieve the country out of the rapid effects of the aging Cuban population and the associated costs for the long-term fiscal balance. The retirement age was extended in five years - it happens to be 65 years for men and 60 years for women-, from 25 to 30 the years of working time and the average pension was increased as well. Also, the law allows the pensioners to work without loosing the right to receive full pension.¹¹

The biggest transformation that will affect the Cuban budget in the next years seems to correspond to the elimination of the gratuities, especially, the suppression of the ration card. Considering the low level of wage and pension, it clearly cannot mean the elimination of the subsidies associated with the ration card, but a change in the form in which such subsidies are allocated.

There is consensus in the matter that the ration card is a distribution proceeding that neither favors does not even encourage work and productivity. It also does not offer alternatives to the consumer, forced to acquire the food in a fixed place, without the possibility of choice among different products. The ration card constitutes a sure way of attending the population with a quota of food at subsidized

¹¹ See Mesa-Lago (2008b) for more details on aging and pension system in Cuba.

prices. It is secure, to the effect that guarantees that there is not unprotected person or family in need. Nevertheless, it is an inefficient expenditure since it assists families that, considering its level of income, do not need such subsidies.

An alternative is not to subsidize products, but directly the families of less income, with what certain levels of fiscal saving can be achieved. The risk, clearly, is not to leave out of the new system of subsidies any citizen who needs it. The challenge is being able to identify the families of low income and those of high income, and to set a really fair divisor line between them.

On this topic the president Raul has said:

“... To gradually solve the existing distortions in the wage system, it is necessary to go forward eliminating the undue gratuities and the excessive subsidies. This means to accomplish the socialistic principle that every one receives according to his or her work... if there is no the pressure, if there does not exist the need to work to satisfy my necessities, and the state is giving to me for free here and there what I need, we are going to get hoarse calling for work“(Castro 2008b).

It is possible to foresee other fiscal transformations along with the policy of major fiscal efficiency and the institutional changes already in course (the institutional changes are summed up in section 6). There is no margin for a countercyclical fiscal policy but there are different ways of recovering the fiscal balance. In the same way of achieving a major fiscal efficiency and implementing reforms that expand the taxable base and the fiscal income, smaller will have to be the contractive adjustments of the fiscal spending.

4. Monetary Policy

4.1 Inflation

The inflation has been under control despite the sharp economic deceleration and the presence of external and internal disequilibrium. In 2008 the Consumer Price Index (CPI) in Cuban pesos diminished 0.1%. In 2009 it diminished 3.3% again, whereas the CPI in convertible pesos increased 1.4%.

In 2009, for the first time, publicly appeared the information of the CPI associated with the markets in convertible pesos. Previously the CPI were published only in Cuban pesos, which registers the prices in this currency on the retail state markets with a weight of 40%, the prices of the agricultural market with a weight of 30%, and the informal market with other 30%; in the latter segment of the CPI the self-

employment sector is included and part of the black market.¹² During this decade the inflation in Cuban pesos was volatile but in average it was low, never rose above one digit (Graph 6).¹³

Graph 6. Inflation in Cuban Pesos, 2000-2009.
(Percentage of change of the CPI)



Source: Elaborated by the author based upon the Cuban National Statistic Office data, ONE (2009a and 2009b) and Central Bank of Cuba (2008)

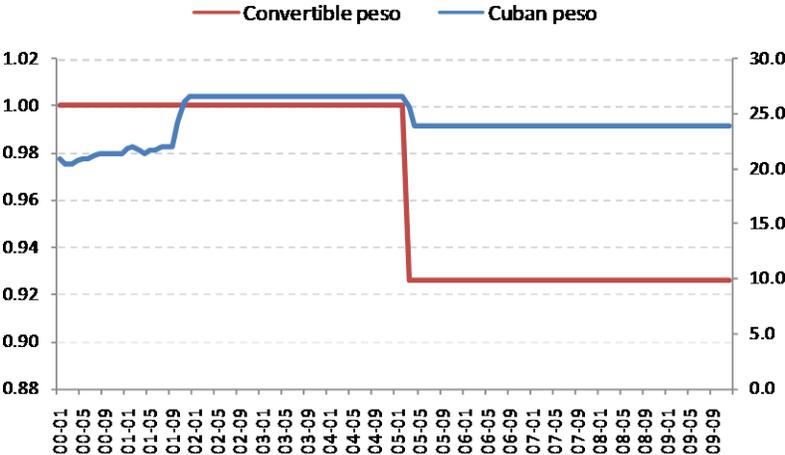
The biggest fiscal deficit in 2008 and 2009, and the consistent monetization, in moments in which the GDP was severely slowed down, major records of inflation for this period were supposed. Additionally, the deficit in the balance of payments in 2008 pressured for the devaluation of the exchange rates, which had encouraged a pass-through to the final consumption prices. This factor was annulled by a policy of fixed exchange rate. The last change of the exchange rate took place in 2005 (Graph 7), both local currencies were revalued with the income support from Venezuela and the trade surplus.

¹² The weights are determined by polls carried out by the Cuban National Statistic Office (ONE), about household spending.

¹³ It is not visible a relevant inflation in convertible pesos. Most of the prices in convertible pesos are centrally determined by the government. The CPI in Cuban pesos is more valuable for estimating the underlying or structural inflation since includes free supply and demand market. See Vidal (2008a) for the transmission mechanisms of monetary policy in Cuba.

Graph 7. Exchange Rate of the Cuban peso (currency exchange houses) and of the convertible pesos, 2000-2009.

(Cuban pesos for a convertible pesos. Convertible pesos for an American dollar, right axis)



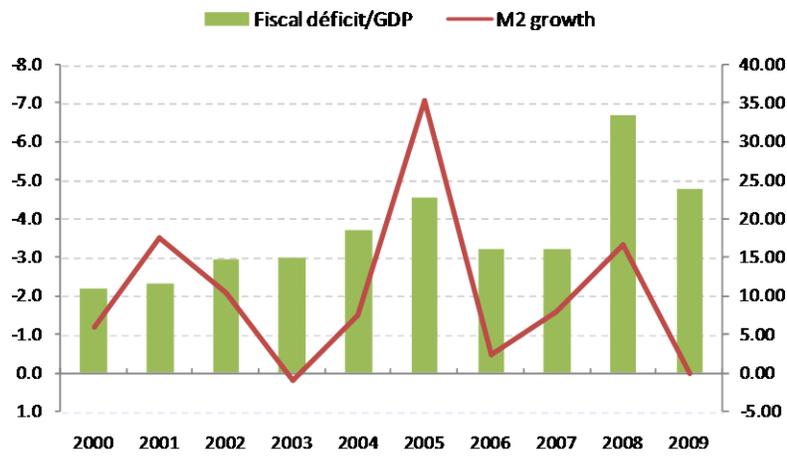
Source: Vidal (2008a)

The defense of the exchange rate led to a sterilization of the Cuban peso’s money supply in 2009. In 2008, the money supply measured by the monetary aggregate M2 (cash and saving accounts in Cuban pesos owned by the population) grew 16.8% in accordance with the biggest fiscal deficit of the decade, but, in 2009, the money supply diminished 0.1% in moments in which the second biggest fiscal deficit was taken place. The biggest increase of the M2 in the decade took place in 2005 with 35.5%, as a consequence of the dedollarization. The fixed exchange rate takes the foreign exchange market to operate every year as money-expansion or sterilizing of M2 and sometimes it breaks the positive correlation between monetization of the fiscal deficit and money supply, as it happened in 2009 (Graph 8).

Cuba went through one of the periods of highest inflation during the crisis of 1991-1993. In those years the fall of the GDP and the imbalances were incomparably major than the current ones. Nevertheless, is useful to highlight that the hyperinflation was determined by an average expansion during three consecutive years of the money supply up to 30.3% and an annual average devaluation of the exchange rate of the Cuban pesos of 142.6%, factors that today the economic policy has managed to contain (Table 3).

Graph 8. Fiscal Balance and Money Supply (M2), 2000-2009.

(As percentage of the current GDP. M2 in percentage of change, right axis)



Source: Elaborated by the author based upon the Cuban National Statistic Office data, ONE (2009a y 2009b),

Table 3. Comparison of the Current Situation vs. Crisis 1991-1993.

(Percentage)

	GDP variation	Fiscal balance /GDP	M2 variation	Exchange rate variation	Inflation variation
1991-1993	-12.4	-29.8	30.3	142.6	147.8
2008	4.1	-6.7	16.8	0.0	-0.1
2009	1.4	-4.8	-0.1	0.0	-3.3

Source: Elaborated by the author based upon the Cuban National Statistic Office data, ONE (2009a and 2009b) and ECLAC (1997)

To be able to support the value of the exchange rate, the Central Bank must have used international reserves in order to cover the excess demand for foreign currency derived from the deficit in the balance of payments. The intervention of the Central Bank has served also to sterilize the fiscal deficit monetization. These actions explain the absence of inflation during the period 2008-2009. Is really meritorious the preservation of the price stability on the present conditions. Nevertheless, it is necessary to point out that the course by means of which the economic policy had accomplished this goal has had harmful consequences that could be if not eliminated, at least reduced.

Since 2008 the monetary policy could allowed an opportune and gradual devaluation of the convertible pesos with regard to the dollar and other foreign currencies helping the balance of payments equilibrium. The exchange rate of the convertible peso is a potential instrument already in hands of the economic policy since the dedollarization in 2003-2004. A devaluation of the convertible peso would transmit a signal over the relative prices, generating incentives to exports and imports substitution, and would have benefited tourism competitiveness. It had also helped to the equilibrium of the foreign exchange market on having reduced the purchasing power, in term of dollars and other currencies, of the bank accounts in convertible pesos, which are today a source of the excess demand for foreign currency.

The devaluation of the convertible peso's exchange rate has some potential risks on price and financial stability. Nevertheless, the state retail stores, which operate with a high commercial markup, might have used it to absorb the inflationary effects of the devaluation of the convertible pesos. By means of the control of the exchange rate of the Cuban peso in the currency exchange houses could be possible to keep a low inflation in this money denomination and preserve the real wage. Along with the inflation, another factor of risk had been associated with the enterprises with uncovered debts in foreign currencies. However, the possible implications in some of these debts had never been superior to the current banking crisis.

In effect, the fixed exchange rate policy did not contribute to the foreign exchange market equilibrium and to the balance of payments, and along with other previous decisions on economic policy seems to be motivated the crisis in the Cuban banks. The deterioration of the macroeconomic conditions impacted, with major rigor on this occasion, the Cuban banks as they were exposed since 2003 to the centralization of the financial resources and to the unlimited expansion of the convertible peso's monetary base after the dedollarization of the economy. The intervention of the monetary policy to support the exchange rate implied a reduction of the international reserves and left the Central Bank with less liquidity to act as lender of last resort of the banking system. From the beginnings of 2009 the banking system and the Central Bank have not enough foreign exchange liquidity to actually support the current functioning of the payment systems. In the following sections, such a situation is more deeply commented.

It is foreseeable that the inflation would increases during 2010 for pressures that would come especially from the supply side. The government, since 2009, has executed a meritorious adjustment of the deficit

of the balance of payments, the fiscal deficit and the Cuban peso's money supply, with which the inflationary pressures from the demand side remain under control. Nevertheless, the stagnation of the GDP and the banking crisis begin to cause shortage on the local markets, situating again the monetary equilibrium under risk.

4.2 Monetary Duality

One of the promises of the Raul Castro's government is to definitively eliminate the double monetary circulation in the Cuban economy. In the first two years of his presidency, significant actions have not been yet materialized in this sense; the economic policy keeps on postponing this complicated matter.

The monetary duality began in Cuba with a process of partial dollarization during the nineties, connected to the economic crisis, the disequilibrium and the inflation. After approximately ten years, steps were implemented in 2003 and 2004 that first dedollarized most of the current accounts and the transactions between the state enterprises, thereafter, the retail stores and most of the population saving accounts. An implicit element is that the dedollarization was possible thanks to the recovery of the price stability from 1995, which provided the confidence the local currencies needed to substitute the American dollar.

If the American dollar had been replaced by the Cuban peso in 2003-2004, the dedollarization would have meant the elimination of the monetary duplicity. But it did not happen that way. The currency that principally replaced the functions of the dollar was the convertible peso, a currency that was issued in 1994 for the first time and was slowly gaining presence in the circulation. Thus it goes over to the present situation, in which the economy is already not dollarized but the monetary duality is present in the Cuban economy, circulating in parallel two domestic currencies: the Cuban peso and the convertible peso.

It was easier in 2003 and 2004 to take the economy from the American dollar towards the convertible peso, than towards the Cuban peso, since a single exchange rate existed for this currency (in that moment 1 convertible peso = 1 USD) which did not seem to be overvalued, given that, it had been endorsed by a currency board since 1994; that is to say, for every convertible peso in circulation there was a dollar on reserve in the Central Bank. In contrast, the Cuban peso has two exchange rates and one

of them is extremely overvalued. The duplicity of the exchange rate of the Cuban peso is the main factor that has complicated the elimination of the double currency in the Cuban economy.

The exchange rate situation of the Cuban peso is the following one:

- For the natural persons, 24 Cuban pesos is equivalent to 1 convertible peso. At this exchange rate individuals buy and sell Cuban pesos in the currency exchange houses. The natural persons have access to markets of goods and services in Cuban pesos and in convertible pesos; they also have bank accounts in these two money denominations and in American dollars. At the beginning of 2008 the saving of the natural persons took the following structure by currency: 58.9% in Cuban peso, 35.9% in convertible peso and 5.2% in American dollars

It is prohibited for the enterprises or the institutions to make any kind of transactions in the currency exchange houses.

- For the Cuban enterprises and institutions 1 Cuban peso is equivalent to 1 convertible peso. The legal persons cannot buy convertible pesos or foreign currencies with their income in Cuban pesos. The enterprises that operate in Cuban pesos receive a centralized convertible pesos allocation to carry any imports out. The exchange rate of the Cuban peso for enterprises -also called official exchange rate of the Cuban peso- especially works for accountant purposes: for the conformation of the balance sheet of the institutions that operate with two currencies (pesos and convertible pesos) and for the record of the national accounts.

The economic policy needs to unify the currency exchange markets to be able to eliminate the double monetary system, to replace the convertible peso with the Cuban peso, or on the contrary, if is the case. In this exchange market unification, an essential step is to correct the over-valuation of the Cuban peso in the enterprises; it is required to devalue the Cuban peso in the enterprises (1x1) to bring the exchange rates closer to that of the population (24x1). The problem is the great gap between the two exchange rates and the financial tensions that bear a devaluation of such a magnitude. It explains the fact that the elimination of the double currency should be a process of several years and not a one day step.¹⁴

The monetary duality and the duplicity of the exchange rates have enormous costs for the entrepreneurial sector. In the first instance, it distorts the economic measurement and the decisions

¹⁴ See Vidal (2008a) for more detail on the monetary duplicity in Cuba.

and derivative allocations of resources. The excessive value of the Cuban peso hides subsidies and keeps artificially profitably a group of enterprises and deceitfully unprofitable, another group, without allowing a suitable measurement of its efficiency and international competitiveness. Additionally, the monetary duality reduces the potential of the internal market, provokes absurd segmentations and reduces economic linkages, finally weakening the economy.

A subjective factor that complicates the elimination of the monetary duality is the wrong expectation the population has on this matter. There is an erroneous perception about the double monetary system since a great amount of the Cuban believe that is the cause of their income inequalities, even when structural and not monetary factors are the real determinants of the low wages. In fact, since 2009, some state retail stores, that were operating with convertibles pesos, had begun to operate in Cuban pesos and no favorable impact took place on the real income of the population. As the matter of fact, the stores can only keep similar levels of prices than those expressed in Cuban pesos using the current rate of 24x1.¹⁵ Meanwhile, an additional challenge that the government will face in the elimination of the double monetary system, has to do with nonconformities of the population, once they do not appreciate a direct and immediate impact on its standard of living.

4.3 Foreign exchange control and centralization

The decentralization of the enterprises management was a component of the nineties reforms. The proper dollarization granted financial autonomy to the enterprises. The decentralization of the foreign trade and the diversification of the Cuban bank and the financial system propitiated bigger free capitals flows and international trade operations.

The year 2003 is identified as a step back to the procedures of excessive centralization. From the proper government the decentralization of the nineties was criticized and associated with corruption and financial malpractices. The dedollarization, which began on that year, gave way to a mechanism of exchange control, called Committee of Foreign Exchange Approval (CAD, in Spanish) and finally to the Unique Income State Currency Account.

In 2003, the state enterprises that previously were operating in American dollars began to make their transactions in convertible pesos, so they needed the authorization of the CAD to be able to purchase

¹⁵ The state retail stores can apply a lower markup to reduce the level of prices, but that has nothing to do with monetary duality.

the necessary foreign currencies for imports, debts payments or other foreign payments. In this way, the exchange control regime for the convertible peso in the entrepreneurial sector was implemented in replacement of the dollarization regime (Central Bank of Cuba 2003).

In 2005, the CAD functions were extended, and begun to approve not only the foreign currency purchasing but all the payments in convertible pesos. That is, it went from the exchange control regime to the approval of all the payments in foreign currency and convertible pesos in the entrepreneurial sector. The banks could not proceed with any payment on these money denominations if they did not have the authorization of the CAD. Additionally the Unique Income State Currency Account was created to where the enterprises were forced to send their profit, taxes payment and other contributions in foreign currency and also in convertible pesos (See Central Bank of Cuba 2004). At the end, the state enterprises lost the autonomy to handle their incomes and the centralized and discretionary allocation of financial resources was reinforced.

The economic policy under Raul Castro's control has partially dismantled the centralization. Specifically, the CAD was eliminated and replaced with an approval system at ministries level. The banks can already proceed with payments in convertible pesos and foreign currency without the authorization of the CAD. The Unique State Income Account keeps on absorbing the state incomes in a centralized way but now that income is distribute to every ministry, and therefore, they are in charge of distributing the foreign exchange liquidity between their subordinated enterprises.

Some sectors and decisive enterprises in the generation of exports recaptured part of their autonomy in handling their financial resources; such is the case of the nickel, tourism, biotechnology, aviation, telecommunications, rum and tobacco. In December, 2009 the new Minister of Economics and Planning stated that "... there have been approved or about to be approved closed systems of financing that will spread whenever necessary and possible. Thus productions that constitute important items of exports will be able to have opportunely the necessary foreign exchange financing, not subordinated to other priorities." (Murillo 2009)

5. Banking System

From 1961 until the eighties only one bank existed in the Cuban economy: the National Bank of Cuba. This bank concentrated the functions of central, commercial banking, bank of investments and was in

charge of the international financial operations. During the nineties the financial system experienced a drastic transformation. A two levels financial system was build up, headed by the Central Bank of Cuba as rector of the system, in charge of the monetary policy, acting as a state fiscal agent and looking over the payments system. Also, the Central Bank was assuming the responsibility of supervising and controlling the financial institutions, of establishing the regulations on the minimal capital, legal reserve requirements, concentration of risk, and policy of provisions among other preventive actions of financial instability.

The Cuban financial system is now integrated by 9 banks and a group of non-banking financial institutions and offices of representation of foreign financial institutions. The system was modernized, developed new financial services and new forms of intermediation.

From 2008, the Cuban financial system has been progressively deteriorating. By mid 2008, Cuba could not meet some of the international financial commitments as direct consequence of the external solvency deterioration. In 2009 the problem scales up with the Cuban banks non-payments to international suppliers and foreign investors. The balance sheets of the Cuban banks do not have sufficient foreign exchange liquidity to face the current functioning of the payment system. The banks are in a situation of systemic liquidity crisis without a lender of last resort to help them to overcome it.

The financial crisis manifestations are not related, up to the moment; to a massive withdraw of the population saving accounts- seemingly keeping the confidence in the financial system-, but to the collapse of the entrepreneurial payment system. Practically the external payments and capital outflows from the Cuban banking system stopped; bank transferences that normally took days, were taking several months to be executed. ECLAC (2009b) estimates the non-payments of the Cuban banks between 600 million and 1 billion dollars.

There is not public information needed for a more precise assessment of the Cuban banking crisis. Nevertheless, examining the available macroeconomic data, the current and previous actions of economic policy and taking into account the transmission channels that necessarily occurs between them, the following fundamental determinants of the financial crisis can be identified:

- First of all, the dedollarization of the economy was carried out in 2003 without establishing any transparent rule for the expansion of the convertible peso's monetary base. In 2003 the currency board that was endorsing the convertible pesos broke down, since then the Central Bank has unlimited autonomy to print convertible pesos. The Central Bank financing to the

government in Cuban pesos is restricted every year by the National Assembly in accordance with the fiscal deficit approved; nevertheless, a limit does not exist for the monetization in convertible pesos. Neither is known the fiscal deficit and the value of the money supply in this currency and nor its specific proportion regarding official international reserve. The dedollarization of the economy provided independence to the monetary policy, but the absence of rules and the lack of transparency have driven to an excessive monetary expansion.

- The second promoting factor of the banking crisis was the centralization since 2005 of the financial resources in the Unique Income State Currency Account. The centralization provoked a concentration of the financial risk in only one economic agent, in this case, the central government. It is not the first time that the government faces a deficit in its finance and problems of solvency; the difference is that previously it did not hurt with so many rigors the banks' balance sheets because the liquidity was more diversified among the deposits of the different state enterprises.
- The third factor is related to the worsening of the macroeconomic conditions from 2008. As stated, negative shocks and the global crisis have severely impacted the economy of the island. The union of this factor with the two previous ones led to the detonation of the banking crisis. The indebted central government perceived how its finance was deteriorating and it directly affected and with major degree the banks' balance sheets. The fiscal deficit in both domestic currencies increased and with that, the money supply, now with less limits after the dedollarization of the economy. The monetary expansion augmented the convertible peso's deposits in the Cuban banks without the adequate coverage in official international reserves.
- The fourth factor that has aggravated the financial crisis is the policy of fixed exchange rate. The deficit in the balance of payments and the fiscal budget end up by deteriorating the equilibrium of the foreign exchange market, producing an excess demand for foreign currencies. An opportune and gradual devaluation of the exchange rate of the convertible peso had helped to restore the equilibrium. In opposition, the Central Bank persisted with a fixed exchange rate regime, and employed foreign exchange intervention, using for it, the official international reserves. The intervention on the foreign exchange market catalyzing the depletion of the international reserves, making impossible for the Central Bank to act as a lender of last resort of the banking crisis.

In addition to contributing to the equilibrium of the balance of payments, the devaluation of the convertible pesos would reduce the real value of the monetary base and eliminates pressures on the exchange market. It could be a way to contract the purchasing power of the bank accounts in convertible pesos- in terms of dollars and other foreign currencies - without having to apply the centralized and discretionary process that finally occurred in the adjustment of the imports and the handling of the external debt.

The difficulties in the banking system have negative direct and immediate implications on the credit, the flows of foreign investment and on the operations of foreign trade. The difficulties in the credit and the payments system damage the functioning of the entrepreneurial activity. The most visible consequence nowadays is the shortage of imported goods in the whole internal markets due to the retirement of international suppliers. It is highly unlikely an immediate recovery of the GDP growth under these circumstances.

Part of the payments to foreign suppliers and investors begun to be meet on the second half of 2009, in a very discretionary process. ECLAC (2009b) states that “in the second semester of 2009 the central bank authorized the payment of some overdue (approximately 600 bank accounts), whenever the providers keep making business with Cuba.”

In December, 2009, president Raul Castro said that “there have been reduced in more than one third the retentions of payments accumulated by that date (He refers to August of 2009) ... we ratify the strong will to continue honoring up to the last cent of the assumed commitments, according to the possibilities of the economy” (Castro 2009).

Parts of the consequences on the banking system today are already irreversible; the international confidence in the Cuban banks can not be restored so easily in the short or medium term. The proper crisis of confidence complicates the banking system recovery, since it generates a vicious circle in which there is no stimulus for new financial inflows, and the scarcity of foreign exchange liquidity is deepened.

The stabilization of the banking system requires an international lender of last resort, a difficult factor because Cuba is not a member of the main international financial organizations. The consequences of the global crisis on Venezuela seem to have stopped an exercise of this kind from the Cuba's principal economic ally or from the new Bank of ALBA. Because of the absence of a last resort loan the Cuban government might open major spaces and new facilities for the foreign investment, for example, in the sugar agroindustry, sector that has been prohibited to the foreign investor.

Figure 1. Banking Crisis: Main Determinants and the Economic Policy.



The figure 1 resumes the previous analysis of the banking crisis. This is a complex matter with multiple feedbacks among different variables and economic decisions. The figure only presents the main determinants connected with the macroeconomic situation and the economic policy. The Cuban banking supervision, and the economic policy in general, should identify their mistakes regarding the financial crisis; if the crisis could be avoided or amortized even in the middle of an unfortunate environment for the banks.

6. Institutional Changes

In two years of presidency the Raul Castro's government has taken forward a group of institutional changes. It is on this sphere where more concrete actions have been taken according with the idea of

“reinforcing institutionalization” expressed on all of his speeches. In 2008 Raul said that “it turns out to be necessary and decisive to have strong institutions; political, state, social and juvenile strong institutions ... the major the difficulties are, the more order and discipline are needed, that why is vital to reinforce the institutions, the respect for the law and norms established by ourselves” (Castro 2008a).

Besides representing a different style of management, the reinforcement of institutionalization has led to the reorganization of the ministries and the state apparatus in order to achieve a more efficient and smaller state system. It has driven to merge ministries, and the reduction of the staff linked to the Council of State and the creation of the Republic's General Controller.

In 2008 the Ministry of Foreign Trade and the Ministry of Foreign Investment merged themselves into only one ministry, whereas the Ministry of the Fishing Industry integrated with that of the Food Industry. Other possible mergers in the nearby future are the Ministry of Agriculture and the Ministry of the Sugar Industry, and the integration of the Ministry of Finance and Prices with Economics and Planning, among other mentioned variants.

A central piece of the institutional changes has been the reduction of dependencies on the Council of State, which was concentrating quite a structure of government that was operating parallel to the Ministries. Some of the most significant examples are the transfer of the so-called Scientific Pole – centers of Research on biotechnological and pharmaceutical production- to the Ministry of Science, Technology and Environment; the breakup of the giant state company CUBALSE; and the reorganization and institutionalization associated with the so-called *Battle of Ideas*, responsible for biggest investment projects in sectors like education and health and some of the operations linked to the *Energetic Revolution* and also a centerpiece in some trade agreements with Venezuela and different international programs of collaboration. The projects and the functions managed from the Council of State have been drastically diminished transferring them to the Ministries where they belong to: Construction, Health, Education, Foreign Trade and Foreign Investment or the Ministry of the Basic Industry.

Another step in the institutional changes is the creation in 2009 of the Republic's General Controller, organism that will have to supervise the correct functioning of all the political, administrative and economic structures of the country including its highest levels. The Controller's office will have to head the strategic guidelines given by the government to the institutional order and the discipline in the handling of the scarce fiscal resources.

The institutional reorganization also has implied the replacement of more than one third of the government cabinet in charge, among them the Ministers of Economics and Planning, Foreign Trade, Finance and Prices, Labor and Social Security, Metallurgical Industry and Agriculture. Also the president of the Central Bank was replaced after resigning in 2009, leaving behind twelve years at the head of that institution.

The new Minister of Economics and Planning, Marino Murillo Jorge, was the former director of economic in the Ministry of the Food industry, vice-minister of Economics and Planning and Minister of Commerce from February, 2006. He is recognized for having reorganized and increased the control and the financial discipline in the Ministry of Commerce, in charge of the country internal trade policy and entrusted to provide the basic basket through the ration card. The Minister of Finance and Prices, Lina Pedraza, was an active member of the Secretariat of the Central Committee of the Communist Party and former Minister of Audit and Control, with a strong hand reputation of establishing control and discipline. The new president of the Central Bank comes from the Financial International Bank (BFI, in Spanish), the biggest state bank of the island.

After the dedollarization, the re-installation of the centralization and the exchange control regimen in the middle of the decade, the Central Bank was the institution with major power in designing and implementing the economic policy, displacing out of this roll the Ministry of Economics and Planning. Under the Raul Castro's presidency these have changed. In the ordinary meeting of the National Assembly in December, 2009 the president expressed that “the role of the Ministry of Economics and Planning is elevated as the major staff of the Government in the economic conduction. That's why the election today by this Assembly of the Vice-president of the Government Marino Murillo Jorge as member of the Council of State is not casual” (Castro 2009)

The new officials at the head of the governing institutions of the economic policy do not come from the academic ambiance, or from the most autonomous entrepreneurial system, but from careers inside the proper governmental system. Theirs previous performance does not show an inclination towards the economic liberalization but rather towards the reinforcement of control. Their record suggests that their fundamental capacities would coincide with the goal to reinforce the institutional order, administering the economic crisis and the financial crisis, and controlling fiscal resources. The advances in the latter goal were already perceived in the course of 2009, as explained in the fiscal policy section.

Mesa-Lago (2009) points out that “The new economic leaders are high military or party officials; now there are four generals, two commanders and a former colonel among the Vice-Presidents of the Councils of State and Ministers. The records of these civil servants and militarymen show nothing favorable to reform instead they are strict disciplinarians and endorse control measures, alongside with Raúl’s style and military nature, searching for efficiency through the *‘Perfeccionamiento Empresarial’* initiated by him in the Armed Forces”

The changes in the government cabinet reached up to the replacement of the Vice-president of the Council of State and Executive Secretary of the Cabinet Carlos Lage in a political complex process in which he ended up resigning, together with the Chancellor Felipe Pérez Roque, member of the Council of State, the Central Committee of the Party and the National Assembly. Lage had been the principal designer of the economic reforms of the nineties that led to the introduction of forms of non-state property, some spaces of market, major foreign investment, as well as, to the decentralization of the foreign trade and the entrepreneurial management.

Another important institutional change seemed to begin in 2007 with a call for a national debate on the economic, political and social problems of the country with the objective to look “with the conscious and active participation of the immense majority of the Cuban, the best reachable solutions within the economic possibilities of the country” (Castro 2007b). The first speeches of the president Raul were making emphasis on the need for debate and participation. Nevertheless the debate was fading out without the media participation. There is no substantial advancement in the institutional transparency and a low level of public information about the actions and the results of the economic policy.

7. Structural Changes

In two years of Raul Castro's presidency, three types of transformations stand out with a more structural character, these are; a major liberalization of the consumption, the process of given land to individual in a private base and more flexibility of the labor market. Additionally, it is known that a number of transformations are evaluated in territorial experiments.

Up to the moment, the actions do not cover the promises of changes expressed by Raul and do not represent a substantial modification of the Cuban economic model that in essence keeps closer to the Soviet model than to the very distant market socialism of the Chinese or Vietnamese style. The state

property widely dominates the whole entrepreneurial sector; the private and cooperative property is circumscribed to part of the agriculture and the limited foreign investment; on the services sector the self-employment exists in a very controlled way. The economic authorities set the majority of the prices, as well as, an excessive amount of regulations of the internal and foreign trade, the capital flows and the currency exchange that enormously limit the autonomy of the entrepreneurial initiative. In spite of the changes carried out in the nineties and Raul's new transformations, in the Cuban economic model the market relationship do not set the course of resources allocation, but the planning and the centralization instead.

7.1 Liberalization of Consumption

In the consumption liberalization process the elimination of the prohibitions allowing that the Cuban residents' citizens could stay at touristic hotels and have access to the cellular telephony can be highlighted. Also the state shops stores began to sell some items previously forbidden from import and internal commercialization to Cuban residents' citizens: computers, DVD, bicycles with motors, and electrical appliances. The emergence of these prohibitions during the nineties had essentially a political sense. The government did not want to make more evident the income disparities among the Cuban families. The government was trying "to reduce such disparities" from the spending side, something that end up by encouraging the black market.

Truly, the purchasing power of the families depending only on the state wage and pension does not allow them to access these new goods and services consumption. Such steps benefit the major income consumers who previously had to buy them on the illegal black market at higher prices than those of the legal market.

Gradually, the development of the internal market ends up favoring the national production and the employment. The enlargement of the market consumption generates new incentives to the foreign and domestic investment towards the production aim to the internal consumer. The consumption restrictions, like monetary duality, affect the economic growth focusing the producers only on the exporting market leaving aside the potentialities of the domestic demand. The low wage level truly restricts the domestic consumption. Nevertheless, not taking advantages of the private income potentialities was evidently demonstrated with the demand increase experienced for cellular phone lines and hotels reservations when the ban was finally lifted.

Major consumption liberalization contributes to the fiscal and monetary equilibrium. The increase of the internal consumption represents a bigger fiscal income coming from the state enterprises responsible for the commercialization of the above mentioned goods and services. The selling of goods and services of high income-elasticity avoids the appearance of monetary overhang, as happened during the beginning of the nineties decade (See ECLAC, 1997). From the supply side the benefits of using goods for the private sector like computers and cellular phones generates positive externalities that contribute to the labor productivity.

As referred to in the fiscal policy section, another market that begins to be liberalized is the consumption of regulated goods. Gradually the selling is liberalized, without quantity restrictions, of any food that previously were assigned through the ration card. The liberalization begun with potatoes, pea and chocolate. This transit occurs along with an increase of the product's prices and the subsequent possibility of buying according to necessities and the individual purchasing power.

The most regulated markets are housing and cars. The houses and cars owners cannot sell them legally to other individuals. Only certain persons receive the governmental authorization to import cars. The government selectively assigns the already depressed state production of housings. Artists and professionals with foreign contracts are those who mainly have access to the above mentioned goods.

7.2 Land Distribution

From a sectoral point of view, the economic policy under Raul Castro's government has the agriculture as a priority. There is a contradiction because the country has a great amount of idle land -more than 50% of the agricultural surface- while about 80% of the food domestic consumption is imported. This exercises a structural tension in the balance of payments deteriorated during the last year's increase of international food price. To stimulate the agricultural production and to replace imports was established a process of distribution of idle state land in usufruct to private individuals and cooperatives, enhancing this form of property on the agricultural sector. Until December, 2009 about 920 thousand hectares had been given to more than 100 thousand beneficiaries, which represents 54% of the whole idle area.

Nova (2009) indicates as weaknesses of the new regulations the fact that the period of time for the use of the land in usufruct is of only 10 years for the private ones (although renewable), without distinguishing the kind of crop circle. Also, there is the inability to build necessary facilities for storage

and housing. Nevertheless, Nova (2009) values the action as very positive since “it is available an important quantity of idle land, a valuable human capital, the existence of a significant number of research centers and experimental stations with results, with technology, but the national economy turns out to be importing significant food volumes much from which can be produced under competitive conditions.”

ECLAC (2009a) says that “although this policy can give positive results in the short term, in the medium one, structural reasons will limit it.” The rural population in average is older than the urban one and only represents 25% of the whole population, for that reason the intensive methods of laboring production are less viable. The state has not enough resources to invest for agricultural modernization like machinery, equipments and appliances (capital), meanwhile the private sector has not enough land extensions for the application of modern capital intensive technologies and at the same time, the private sector has little financing possibilities for their investment. ECLAC (2009a) proposition is that the country migrates to an intensive capital method based on knowledge and technology. The country is prepare with excellent conditions to develop new methods of production, better seeds and improve the productivity system, if the country uses its considerable experience in the genetic engineering, but to make use of the above mentioned advance achievements “additional changes will be necessary”.

During the nineties reforms the non-state land property increased from 18% to 46%; in term of cultivated land it represents more than 70%. In those years also land was distributed to non-state producers and Basic Units of Cooperative Production (UBPC) were created, a type of cooperative with less autonomy for the management and the profit appropriation than the Cooperatives of Credits and Services (CCS) and the Cooperatives of Agricultural Production (CPA). Together with the individual farmers, these three forms of cooperative predominate on the production and agricultural yield over the state enterprises (see Nova2009).

Despite changes on the property system, the agricultural sector had remained straggler and a high food foreign dependency permeates the country. The property changed but the market environment to allow purchasing equipment, technology, accessing financing and foreign currency and the finally commercialization to stimulate and promote productivity, remained just unchanged.

One essential factor against the agricultural outputs is the inefficient state controlled final commercialization and the ineffective way in which it is carried out by the state national enterprise responsible for gathering the agricultural outputs and commercialized them, known by the Spanish

acronym of Acopio. It is established that producers have to sell to the state enterprise Acopio up to 70% of the production at excessively low prices, leaving in some cases only 30% for their own commercialization on the agricultural markets. During the last two years Acopio raised some products prices like milk and red meat (cattle) and worked to regularize its debts with private producers, nevertheless, no substantial change has occurred in this state centralized mechanism of commercialization.

There seems to be a governmental will to continue with the structural changes in the agricultural sector. The president said in December, 2009 that “it is an imperative to liberalize in this sector, as in all the others, the productive forces of any restrictions for its development The agricultural development will be favored by various forms of bank financial assistance. ” He added that variants are been studied for “the producers could sell directly on the market the surpluses, under the rules of supply and demand” (Castro 2009).

Nova (2009) states as necessary transformations in the Cuban agriculture the following ones:

- That the commitments of selling to Acopio could be the indispensable ones so that most part of the production could be sell on the market of free supply and demand. Acopio should come to the market as a regular consumer to contract the products under the supply and demand prices.
- To eliminate a series of additional barriers that exist for the free private production and commercialization of the bovine meat, milk derivatives, rice and potatoes.
- To simplify the institutional structures that regulate the agricultural sector and to strengthen the municipal instances.
- To achieve a major participation of the foreign investment.

7.3 Flexibility on the Labor Market

The Resolution 9 of 2008, issued by the Ministry of Labor and Social Security, opens a door towards a major autonomy in the state enterprises for wages setting. A system of payment by results was started in the state enterprises linked to the goods production. The wages’ top limit was eliminated with the objective that the worker’s income depends directly on his or her productivity and performance.

The implementation of the above mentioned resolution has been insufficient; since resistance can be observed among the enterprises in order migrate towards the new wage system. Apparently, two fundamental factors have stopped the effects of the above mentioned resolution: the bureaucratic hobbles and the proper economic slowdown. The excessive bureaucracy and centralization of the economic decisions hinder the enterprises management and makes difficult for them to have a full control of their expenses. The economic stagnation affects the functioning, the available inputs and, in general sense, the profitability of the enterprises. In the middle of a sharp growth decrease new difficulties appear in the enterprises to have positive profitability to back up the new wage system.

Another step for the flexibility on the labor market is the authorization of multiple jobs, such that in certain sectors the workers could be formally hired in more than one job. Nevertheless, this new policy has suffered the same than Resolution 9 and its real impact, up to the moment, is very discreet.

Both policies seem to be aiming towards the correct direction in order to generate work incentives and productivity, two of the structural obstacles to the economic growth. It offers the possibility to the state employees of increasing their income in a moment in which there has begun a process of elimination of subsidies by means of the ration card. Nevertheless, the context does not favor them. In addition to the worsening of the macroeconomic conditions, both policies seem to stay out of place in a context of still strong centralization and low enterprises autonomy that promotes the bureaucracy. The rigidity of the labor market is not the only that determines entrepreneurial perverse incentives, an inefficient labor contracting and low labor productivity.

8. Final Remarks

Without macroeconomic reserve for a countercyclical expansion, the fiscal policy must have carried out an adjustment of the deficit that contributes to the price and financial stability and to the long-term economic growth. It was possible to control the fiscal expenses with institutional changes, a program of fiscal efficiency and the gradual reduction of gratuities and subsidies. A fundamental element of fiscal transformation in this sense is the elimination of the ration card, which shows important challenges due to the low level of real wages and pensions. The policy of spending control was also present in the external equilibrium with a severe imports contraction.

The economic policy, under Raul Castro's control, has been effective from the expenditure side – even when maintained with a centralized and discretionary character-, which is an important step to recapture credibility and financial stability. Nevertheless, the actions to encourage incomes are scarce; even if some positive step had been taken on agriculture, the labor market, consumption liberalization and partial decentralization.

The monetary policy preserved a low inflation by means of the exchange rate control and the monetary sterilization. A critique that arises is the fact that the policy of fixed exchange rate does not contribute to the external equilibrium and together with other factor, induced a banking crisis. Perhaps, it had been preferable to destine the international reserve to support the banks and foreign payments than for keeping the exchange rate. The economic policy avoided the social pressures that would come from an increase of the inflation and a fall of the damaged real wage, but on the other hand, it has the pressure of the foreign suppliers and investors, combined with a banking crisis that shows up on the shortages of the internal markets and constitutes a new threat for the inflation. It is probable that the final outcome of the fixed exchange rate policy would be to contain the inflation only in the short term.

Is not easy at all to get out of the current financial crisis and there are no many options of economic policy, since there is not a lender of last resort. To open to the foreign investment, offering facilities to overcome the actual financial risks, would allow to attract capitals and to make the economy dynamic given the absence of foreign loans. Another option is to deep and speed the fiscal, monetary transformations – including the gradual elimination of the double monetary system - and the structural changes that boost productivity and incomes.

None of these options would allow solving the situation of illiquidity immediately; in fact, viable alternatives are not glimpsed for short-term solution. Consequently, high probabilities remain for the Cuban economy to submerge in a period of stagnation or recession, inevitable at this point for the economic policy. Its duration will depend on the hardness with which the actual financial problems impact the entrepreneurial sector and the population, as well as, of the speed, depth and efficacy of the transformations that should be implemented.

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