Financial economic reforms in Cuba. Rejoining capitalism in an age of crisis

Marcia Solorza

Faculty of Economics at the UNAM, Mexico. E-mail address: luzlunario@gmail.com

Abstract:
In the wake of the dissolution of the Union of Soviet Socialist Republics (USSR), the disappearance of the Council for Mutual Economic Assistance (COMECON), and the flourishing of neoliberalism in a globalized and economically and financially deregulated world, Cuba, with a State-directed economy, has undertaken a series of reforms to begin its slow and complicated transition toward a new paradigm of capitalist development, which will permit it to sort out its domestic problems and deal with the global crisis. These transformations took off with the arrival of Raúl Castro to power and the reopening of political and diplomatic relations with the United States of America. To depict the current scenario, this paper introduces some general aspects of Cuba and analyzes them in the short-, medium-, and long-term scope of the economic reforms.
Key Words: Economic policy, financial reforms, neoliberalism, capitalist development, economic crisis.

Date received: August 11, 2015.
Date accepted: December 7, 2015.

Introduction

Developed capitalist countries began to show signs of economic, political, and social turmoil starting in the mid-1960s, rattling the very foundation upon which post-war growth and development had been built, led by an Interventionist or Welfare State, whose goals were to attain total employment and temper economic cycles. In economic terms, these conditions were expressed in declining profit margins, particularly in the agricultural sector, the overaccumulation of capital in the United States of America (U.S.) and Europe, and encroaching competition from recently-industrialized countries.
Parallel to this, on the other side of the world, the bloc of socialist countries (centralized planning) led by the Union of Soviet Socialist Republics (USSR), following a series of major scientific and economic achievements, began to face prolonged economic stagnation brought on by “institutional sclerosis,”[1] growing political disenchantment both domestically and abroad, and, in some cases, such as Cuba, technology isolation and the U.S. trade embargo.

[1] The term “institutional sclerosis” refers to rigidity in economic, political, and social development derived from institutions, in this case public, created to guarantee political and economic advantages to certain groups.

This was the ideal context for anti-State intervention theories and attacks to flourish, especially those launched by the neoliberal school (laissez-faire policies), bolstered by Hayek's proposals. Both highlighted the efficiency of the globalized free market (except the labor market), monetary and financial deregulation, and a restricted role for the State, turning it into a minimalist State, with the firm intention of rolling back the strides made by the working class and progressive movements, including:[2] the defense of indigenous rights, feminists, gender justice, and more. In other words, the State's capacity to act became constrained, compelling it to revamp both public policy and leading to the transformation of economic institutions (Aoki Masahiko, 1995: 330; Sachs and Woo, 1994: 275).

As such, public investment in enterprises was to be abandoned in light of its inefficiencies and lack of incentives to extract profits, resulting from the absence of competition, high corruption, and a dearth of discipline. Consequently, the privatization of productive and financial assets became an urgent imperative, and the State would begin to dedicate itself to maintaining public order, and, above all, to protecting ownership rights as a basic pillar of the market (Coase, 1960: 1-4).

Relatively removed from the globalizing forces of neoliberal economics in the early 1990s, the Cuban economy, after the fall of the Berlin Wall, the end of the Cold War and, most notably, in the wake of the dissolution of the Council for Mutual Economic Assistance (COMECON), through which the country had received economic aid from the USSR, began to confront the entrenchment of its structural economic problems, prompting the government to begin to enact economic policy changes. This policy pivot would give rise to a slow and deficient (in terms of the high social cost) economic and institutional (not yet complete) transition to a new paradigm of capitalist development, not without some political setbacks.

This paper aims to study the changes that the Cuban economy has undergone in recent years following the rise of Raúl Castro to the position of President of Cuba. The hypothesis is that in its current implementation of economic market reforms, Cuba has sought to accelerate its path to rejoining the global market, portraying itself as an economy highly focused on inflation control, the expansion of microcredit (an instrument to deal with poverty), and tax collection by the State, as its development strategy. In this way, the Cuban economy is positioning itself as a potential pole to attract foreign investment. By becoming a destination for capital oriented towards building the port, trade and industrial infrastructure it needs, the country hopes to raise income levels and the standard of living for its people.

To achieve the objective and hypothesis described here, this paper draws on an empirical–analytical approach to interpret the effects caused by structural reforms in major economic sectors, and sheds light on medium- and long-term impacts. For this reason, this paper is organized into six sections: background; tax reform; monetary and financial reform; foreign direct investment; the scope of economic reforms and medium- and long-term prospects; and conclusions.

Background

[2] These movements are related to the struggle for individual liberties, and are collective movements whose social-democratic demands entail, in many cases, radical changes.

Inspite of the economic sanctions (trade embargo) imposed by the U.S. 50 years ago, and some dissent from Cuban citizens, the administration of former President Fidel Castro managed, over four decades, to establish a “social pact,” a close relationship between state power and the people, and to build a consensus around a national project that continues to be in place even now during the era of Raúl Castro, current head of state and President of the Council of State of the Republic of Cuba, providing the basis of his political power and lending him legitimacy. This social consensus has been underpinned by access to education: technical and higher training, the universal right to healthcare, and constant efforts to keep unemployment as low as possible. Table 1 reveals that although the unemployment rate has been rising since 2006, it is still low, barely above 3%, thanks to the expansion of self-employment which, in 2014 (February) reached the figure of 455,577 people (Suárez, 2014: 1), and has now become a viable option.[3]

Table 1. Economically Active Population (thousands of workers)

Year	*Labor-Age Population*	*Active Population*	*Economic Activity Rate*	*Employed*	*Unemployed*	*Unemployment Rate*
2006	6 721.10	4 847.30	72.12	4 754.60	92.70	1.91
2007	6 721.30	4 956.30	73.74	4 867.67	88.58	1.79
2008	6 726.70	5 027.90	74.75	4 948.20	79.70	1.59
2009	6 840.70	5 158.50	75.41	5 072.40	86.10	1.67
2010	6 829.10	5 112.50	74.86	4 984.50	128.00	2.50
2011	6 802.90	5 174.50	76.06	5 010.20	164.30	3.18
2012	6 845.20	5 077.90	74.18	4 902.20	175.70	3.46
2013	6 976.10	5 086.00	72.91	4 918.80	167.20	3.29

Source: National Office of Statistics and Information (ONEI), Employment and Wages from the Statistical Yearbook 2011, 2012 Edition, and the Statistical Yearbook 2013, 2014 Edition, Cuba.

From 1959 to the end of the 1980s, a time during which Cuba received support from the COMECON, the island was able to develop with public investment, primarily in infrastructure, manufacturing facilities, and adding technology to the agricultural sector. At the same time, Cuba managed to preserve social unity and discipline and its cultural foundation, without breaking diplomatic and trade ties to the socialist world and other economies, including Canada, Spain, and Latin American countries. However, these efforts did not help Cuba move beyond an economic structure based on the export of primary goods. In fact, to date, the country’s principal exports are still related to nickel mining, fishing, sugar production, rum, and tobacco.

In the 1990s, Cuba experienced a crisis, during which its Gross Domestic Product (GDP) contracted by 32% between 1989 and 1993, exports plummeted 20.8% in 1998, and the unemployment rate rose to 7.5% in 1995 (Cepal, 2000: 578), spurring a currency scarcity. Since then, food shortages have become a constant, especially following the enactment of the U.S. Torricelli Act (1992), and the Helms-Burton Act of 1996, as well as a major impact on trade beginning in the early twenty-first century as a result of some third-party countries

[3] Of the people authorized as self-employed workers, 68% did not have any prior employment ties, 18% were wage workers, and 14% were retired.

choosing not to stand up against the trade restrictions imposed by the Bush Administration in 2004 and 2006 on behalf of the U.S. (Lamrani, 2011: 4-7). Likewise, the first global financial crisis of the twenty-first century and the natural catastrophes of 2008 (Hurricanes Gustav and Ike), in addition to irregular rainfall in 2010, have had a disastrous impact on Cuba (damaged or destroyed homes, tons of wasted food, dismantled power infrastructure, ruined drinking water reserves, and failed crops), which came together with price hikes in raw materials for the food industry, on which the country is dependent, and a 50% decrease in international nickel prices (nickel and sugar exports are the motor of the Cuban economy), leading to deteriorated terms of exchange and, as a result, a rising public deficit and unfavorable balance of payments.

In light of these circumstances, since 2008, the Cuban State has, on the one hand, blocked financial transfers abroad to prevent capital flight and renegotiated its foreign debt to the tune of 13.6 billion dollars with some countries, as well as sought to reach agreements with the Paris Club[4] to further reduce it, improve its reputation in international financial markets, issue new debt bonds and, in this way, expand its range of financing options subject to the international credit granted by the International Investment Bank.[5] On the other hand, it has sped up and deepened a series of economic and financial reforms dating back to the 1990s, aiming to find external sources of financing. In a few years, the country may even gain access to credit from international financial bodies, including the International Monetary Fund (IMF) and the World Bank (WB), of which it is not yet a member, commitments that may oblige the country to restrict its capacity for action, radically modify ownership rights[6] (in 2008, Decree-Law 259 allowed the leasing of idle lands in usufruct), transform its legal and economic institutionality, and redesign public policy in light of the rising autonomy of the civil society.

Cuba has been fueling the interest of foreign investors, whether in the tourism sector, the productive sector (both agriculture and manufacturing), or the energy and mining sector, and could even begin to invite investment into the microfinance and microcredit sector through strategic planning policies to adapt to help the population adapt to conventional measures of efficiency, productivity, and market competition, while also encouraging financial education programs to complement the small-scale liberalization of the non-state economic sector.

Unlike other Latin American countries (Mexico included), Cuba has a very significant competitive advantage for foreign investors: a qualified labor force that could be trained to adapt and be upgraded to assimilate the use of new technologies. Tables 2 and 3 show a clear trend that education levels are rising among the economically active population (EAP). The percentage of people with upper secondary school (high-school level) education and higher

---

[4] Over the past three years, Cuba has been restructuring and meeting its debt commitments with China, Japan, Mexico, and Russia, and has achieved substantial cuts by presenting payment plans with which it can comply. It is also looking to make a deal with the Paris Club (19 creditors: Germany, Australia, Austria, Belgium, Canada, Denmark, Spain, U.S., Finland, France, Great Britain, Holland, Ireland, Italy, Japan, Norway, Russia, Sweden, and Switzerland).

[5] This bank was created in 1970 by the COMECON and its members are: Bulgaria, Romania, Mongolia, Vietnam, Czech Republic, and Russia.

[6] The struggle against state ownership by the mainstream argued that the absence of private ownership in socialist countries such as Cuba takes away any individual motivation to increase efficiency and improve productivity.

education (university studies) is constantly growing. In 2006-2013, the number of workers with only primary school education fell from 478,100 to 264,500, figures that represent 7% and 3.7% of workers, respectively, while the number of workers with secondary school education (technical level) fell from 1,346,200 to 1,103,100 (19.64% and 15.54%, respectively), and the number of workers with upper secondary schooling rose from 2,357,300 to 2,653,400, or from 34.4% to 37.38%, respectively. In addition, workers with higher education, which numbered 665,700 in 2006, rose to above one million people (1,065,000) in 2013, implying a leap from 9.7% to 15%, in other words, substantial growth. These evolving education levels among the EAP in Cuba can be seen in Tables 2 and 3, where negative figures indicate that those who had a lower degree of education studied to obtain a higher level of education.

Rising education levels and better healthcare represent just some of the commitments and needs that the socialist State has achieved and met over time. The State is continuing to do so, despite the high cost of maintaining an aging population with 2,233,465 elderly persons, which amounts to around 20% of the total population of 11,167,325 people. However, Cuba's economic restructuring has brought with it a reduced role for the State, especially as a promotor of growth, limiting its business activities and requiring it to meet new needs created by new forms of ownership: individual, cooperative, state, and foreign. As such, the principal economic and financial reforms made to the Cuban development model include trade and credit liberalization, commercial debt restructuring with other countries, increased foreign investment to compensate for the decline of tourism (in recent years) and imbalances in the balance of payments, monetary and banking reform, and tax reform that is acting as the new motor of growth for the economy. The economic and financial reforms set forth in the "Guidelines of the Economic and Social Policy of the Party and the Revolution" (Sexto Congreso del Partido Comunista de Cuba PCC, 2011: 23-38), consist of the following:

1. Spending adjustments for the education, healthcare, sports, and culture budget.
2. Employment adjustments in the state sector.
3. Reorganization of the state apparatus, ministries, and large state enterprises.
4. Leasing of idle lands in usufruct.
5. Separation of state and business functions.
6. Incentives for self-employment and greater business autonomy.
7. Creation of non-agricultural cooperatives.
8. Autonomy for local governments in developing their own projects.
9. Elimination of some prohibitions such as the sale of homes, cars, mobile phones, and other goods and services.
10. Rescheduling of foreign debt payments.
11. Creation of Special Development Zones.
12. Updates to the Tax Policy.

Table 2. Education Levels of the Economically Active Population (thousands of workers)

	2000	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*
Primary or lower	745.8	704.6	670.0	598.4	567.5	514.7	478.1	396.7	401.0	369.2	341.1	318.7	314.0	264.5

Secondary	1 416.5	1 423.6	1 435.5	1 425.6	1 409.5	1 443.9	1 346.2	1 353.9	1 353.4	1 295.5	1 229.3	1 197.9	1 127.0	1 103.1
Upper secondary	1 867.8	1 938.2	1 975.6	2 032.4	2 085.3	2 195.7	2 357.3	2 476.2	2 545.9	2 718.1	2 733.2	2 691.9	2 664.2	2 653.4
Higher	601.4	630.3	633.2	660.2	667.1	662.1	665.7	729.5	727.6	775.7	808.9	966.0	972.8	1 065.0
Total	6 631.5	6 697.7	6 716.3	6 719.6	6 733.4	6 821.4	6 853.2	6 963.3	7 035.9	7 167.5	7 122.5	7 185.5	7 089.9	7 099.0

Source: National Office of Statistics and Information (ONEI), Employment and Wages from the Statistical Yearbook 2011, 2012 Edition, and the Statistical Yearbook 2013, 2014 Edition, Cuba.

Table 3. Education Levels of the Economically Active Population (Percentage Change)

	2000-2001	*2001-2002*	*2002-2003*	*2003-2004*	*2004-2005*	*2005-2006*	*2006-2007*	*2007-2008*	*2008-2009*	*2009-2010*	*2010-2011*	*2011-2012*	*2012-2013*	*Average*
Primary or lower	-5.52	-4.91	-10.69	-5.16	-9.30	-7.11	-17.03	1.08	-7.93	-7.61	-6.57	-1.49	-15.75	-7.54
Secondary	0.50	0.84	-0.69	-1.13	2.44	-6.77	0.57	-0.04	-4.28	-5.11	-2.55	-5.92	-2.12	-1.87
Upper secondary	3.77	1.93	2.88	2.60	5.29	7.36	5.05	2.81	6.76	0.56	-1.51	-1.03	-0.41	2.77
Higher	4.81	0.46	4.26	1.05	-0.75	0.54	9.58	-0.26	6.61	4.28	19.42	0.70	9.48	4.63

Source: National Office of Statistics and Information (ONEI), Employment and Wages from the Statistical Yearbook 2011, 2012 Edition, and the Statistical Yearbook 2013, 2014 Edition, Cuba.

As part of the economic and financial reforms, tax reforms are playing an overwhelming role in achieving two objectives: *1*) ensuring that individual owners, cooperatives, and foreign owners pay taxes, and *2*) making sure that the State has sufficient revenue to fulfill its duties and cover its financial obligations.

Tax reform

The purpose of the tax reforms dating back to the 1990s has always been to endow the State with more resources. This process, with both a long- and short-term scope, has taken off in recent years with the enactment of Law No. 113 of the Tax System published in Official Gazette No. 53 on November 21, 2012, setting forth the taxes, principles, standards, and general procedures upon which the Republic of Cuba's Tax System would be based. Of course, these new tax regulations repealed and replaced Law No. 73 of 1994, Decree-Law 169 of 1997, and other regulations issued by the Ministry of Finance and Prices that regulated tax activities in Cuba.

Now, with the new Tax System Law, Cubans are subject to tax obligations and must pay a total of 19 taxes, three contributions, and three rates. The "new taxes cover payments for personal income" applicable to Cubans and foreigners with permanent residency in the country, to all income earned both within and outside of Cuba, and shall also be levied upon Cubans and foreigners who do not have permanent residency in the country but generate income within it.

The regulations also set tax payments on profits and sales, a special tax on products and services, ownership or possession of agricultural lands, home ownership and ownership of vacant lands, idle agricultural and forestry lands, land and air transport, ownership or possession of ships, inheritance and transfer of assets, utilization of the labor force, use or exploitation of beaches, approved dumping of wastewater into river basins, use and exploitation of bays, use and exploitation of forest resources and wild fauna, usage rights for inland waters, and commercial advertising, as well as customs taxes.

However, the People’s Power Assembly has stated that for now, the right “conditions are not created,” and has approved a short-term postponement of enforcement of taxes on personal income, salaries, and home ownership. In addition, contributions must be made for social security, as well as territorial contributions for local development.

This tax reform entails a complete transformation of the social role of the State, putting an end to "state paternalism" and essentially sanctioning any affront to ecosystem diversity. In other words, in this last matter, Cuba is doing what other developing countries, or countries that have developed in recent years, such as China, have not done, foreseeing that the changes entailed by trade liberalization, export-oriented production, and the inflow of new cars could, in the medium and long term, cause irreversible environmental damage.

Cuba’s gradual efforts to rejoin capitalism require more than just tax policy reform. It will also be essential to reform its institutions in general. In particular, the country needs a series of complex monetary and financial reforms to lay the groundwork for a financial and payments system on par with international standards. In this way, in the medium term, foreign investment can flow quickly into the island, whether directed at market liberalization, the integration of productive chains, the acquisition of existing companies, the introduction of new technologies, agricultural production, subcontracting, or the banking and financial spheres.

Monetary and financial reform

Cuba began its monetary and financial reforms at the end of the 1990s and it has been from that point forward that the banking sector has undergone changes, aiming to deal with the lack of financing for the productive sector and generate competition between banks. With this in mind, a two-level credit system was set up, and Cuba created a Central Bank in 1997

(Solorza, 2007: 182-183). Nowadays, by speeding up Cuba's reinsertion into the global economy, the modernization of its monetary and financial policy has followed a path to control inflation and achieve two substantial objectives: *1*) end monetary duality, with the convertible Cuban peso (CUC) and the Cuban peso (PUC), and *2*) expand microfinance and microcredit.

In regard to the first task, Resolution 19 from 2014 published in the Official Cuban Gazette of the Ministry of Finance and Prices offers a series of indications about how state entities should proceed to make monetary unification a reality. It issues an accounting standard that sets forth the procedure for accounting records in the process of eliminating the convertible peso from financial transactions between economic entities, as well as a methodology to implement the post-CUC price policy. The elimination of the dual currency will take place when the unifying rate at which Cuban pesos are listed enters into force. This rate will be set before one of the currencies disappears, a task that presumably will happen in the medium term.

Pavel Vidal and Omar Everleny Pérez, Cuban economists and officials involved in Cuba's monetary and financial reforms, have asserted that the (real) devaluation of the official exchange rate of the Cuban peso is the first action that the Central Bank of Cuba (BCC) must undertake to move beyond the dual currency system,[7] meaning that the Central Bank must set the unifying rate. However, the currency devaluation will change practically all proportions, prices, and financial results reported by companies, banks, and other institutions, as well as the State budget, a reason for which it is presupposed that the financial statements of some companies will list debts in convertible pesos (CUC) and foreign currencies superior to their assets in these currencies. These experts on the topic have also noted that a secondary effect would be an increase in the inflation rate, which has been erratic in recent years, as shown in data from the Economic Commission for Latin America and the Caribbean (ECLAC) in Figure 1, due to rising costs (in convertible pesos and foreign currency) expressed in Cuban pesos. It is estimated that costs are likely to rise when multiplied by a higher exchange rate, and that these rising costs could be transferred by companies to the final prices of the goods and services they sell (Vidal and Pérez, 2013: 13-18).

In this same sense, following Vidal and Pérez, it appears that private companies in the financial sector, such as banks, in particular the Banco Popular de Ahorro (BPA), the Banco de Crédito y Comercio (BANDEC), and the Banco Metropolitano (BM), would suffer direct repercussions on their balance sheets when the peso is devalued, because they accept deposits and grant loans in PUC and in CUC. They would also be impacted as a result of the financial relationships they hold with companies, especially non-export companies, a circumstance that would reduce their capacity to repay debt. For these reasons, Vidal and Pérez advise that preventive measures should be taken to define mitigating actions and conduct stress tests to determine how vulnerable the banking system would be before a devaluation takes place (2013: 19-20).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), National Accounts, Consumer Price Index variations: December to December.

[7] This is because they begin by observing the over-valuation of the Cuban peso.

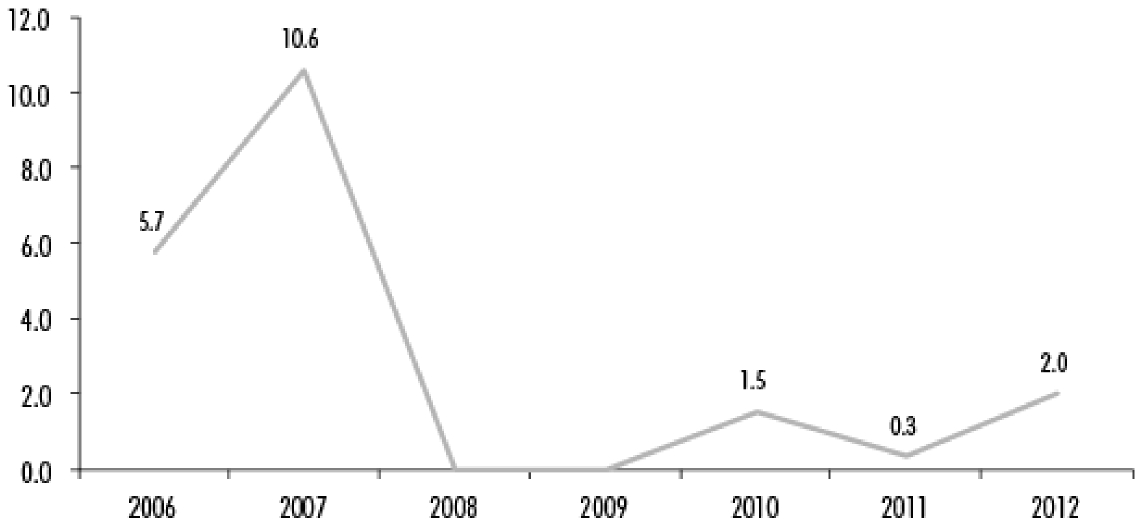

Figure 1. Inflation (Annual Rates)

In regard to the second monetary and financial reform objective, it is necessary to note that microfinance institutions constitute a system of non-banking entities that run the gamut from individual lenders to formal institutions such as small local banks, credit unions, financial cooperatives, public banks, and capital funds from social enterprises. All of these are dedicated to making microcredit accessible, referring to small loans used by poor people for income-generating economic activities (Bateman and Chang, 2012: 14), providing financial services to self-employed people[8] and private microenterprises, increasing credit facilities for private farm workers, creating urban cooperatives, and in general, providing microcredit to people in situations of poverty.

According to Bateman and Chang, in developing and transition economies, the microfinance sector has become positioned as one of the most important ways to reduce poverty. Even so, these authors believe that the microfinance model can produce positive outcomes for a few small poor entrepreneurs in the short term, but in the long term, its role is debatable because the empowerment of these people can be a barrier to sustainable economic development for the country, including social development, and poverty reduction (Bateman and Chang, 2012: 1). Moreover, in strictly economic term, because microfinance is oriented towards local microenterprise start-ups that are unable to reach the minimum scale of efficiency needed to be competitive, and may ignore the importance of economies of scale, or opt out of using and generating technology that in the long term would make the domestic economy sustainable, it may stand in the way of, or in the best case delay, industrialization, widening inequalities and simply redistributing poverty.

In Cuba, it will be difficult to see positive results in the short term following the granting of microcredit to male or female self-employed workers, because the new regulatory framework still does not permit the incorporation of small and medium-sized enterprises (SMEs), despite their mention in the Guidelines of the Economic and Social Policy of the Party and the

[8] In Cuba, there are 181 private economic activities authorized by the State, in which men and women take part and organize private businesses supported by their families. Examples include: butcher shops, shoe stores, sale of handicrafts, etc. It is important to note that these are established businesses or businesses conducted through *"tianguis"* (marketplaces) and pay taxes, permits, and social security (savings for retirement).

Revolution. Even though the expansion of microfinance and microcredit is disrupting the "credit culture" of the Cuban economy in which state enterprises have historically managed the granting of credit for over half a century (as of 2007, accounting for 70% of credit, while agriculture and livestock cooperatives controlled 28.5%, and private farmers only received 1.5%), the State, through economic and financial transformations, is promoting the creation of microfinance[9] and microcredit institutions that provide financial services and products to micro- and small enterprises (owners and employees), and is authorizing state banks to grant personal loans to repair and build housing. In turn, the State has left the door open to the future expansion of credit to consumer goods and the purchase of homes and cars, showing that it is beginning to accept the existence of market relationships between private micro-enterprises, self-employed workers, and homes with state banks, anticipating potentially absorbing defaults itself, which would socialize debt.

Due to the dearth of specialized microfinance institutions in Cuba, the Central Bank (BCC) and three state banks are the main entities in charge of conducting microfinance activities: the Banco Popular de Ahorro (BPA) and the Banco Metropolitano (BM) serve clients from Havana, while the Banco de Desarrollo (BANDES) provides services to clients from the rest of the country. As such, state banking institutions are responding to the new credit and financial service needs pursuant to the terms set forth in Official Gazette 40 from 2011: there is no maximum limit for credit amounts, guarantees above 80% of the amount loaned above 5,000 CUC; and the interest rate for both individuals and legal entities is set by summing a margin approved by the BCC between 0.25 and 2.5% to the current interest rates in effect for fixed-term deposits in Cuban pesos, 4% for a one-year term, and 6.5% for five-year deposits. In other words, interest rates range between 4.25% and 9.0%, as can be seen in Tables 4 and 5.

According to the BCC (http://www.bc.gov.cu, 2011: 1), the margins approved depend on the purpose of the credit and banks can move between the maximum and minimum of the range pursuant to the risk analyses they conduct for each client. Rates are as follows:

1. Working or investment capital up to one year (1% 0.5%)
2. Working or investment capital above one year (1.5% 1%)
3. Purchase of construction materials or payment of labor services (0.2%)
4. Durable consumer goods (2% 1%)
5. Surcharge for arrears not to exceed (4%)

To the above is added the fact that microfinance institutions, to render services, must require that credit applicants submit an evaluated productive or commercial project, specifying business feasibility and guarantees (which may be seized in case of non-compliance as stated in the loan contract), which may consist of bank deposits on behalf of the applicant or third parties, movable goods (pledges), mortgages on houses in summer or vacation zones, vacant lands, and others that may not include the permanent home or property of the debtor. Since 2011 (year of approval), microfinance institutions in Cuba have had to experience a process

[9] Some of the financial services that are offered include: micro-savings, micro-life and health insurance, money transfers, remittance receiving, group and joint loans, pre-loan savings requirements, micro-leases, and modern payment systems and instruments. The microcredits consist of loans worth small amounts, ranging from 100 to 1,000 dollars, granted primarily to female micro-entrepreneurs.

of institutional learning, regulatory changes, and incremental modernizations of the legal framework, consolidating future guarantees for the sector. Likewise, since their creation, microfinance institutions have encouraged the growth of private business, whether they are individuals or start-ups in the private chain of services and products, especially in the capital of the country. At the same time, they have increased the concentration levels of this sector and made the services generated by the private financial sector more complex (Triana, 2013: 2).

Table 4. Interest Rates 2011-2014, Entities

							Term (months)
Currency	*At Sight*	*1*	*3*	*6*	*12*	*24*	*36*
CUC	1.75	2.25	2.25	2.25	2.50	2.75	3.25
USD	1.75	2.00	2.10	2.15	2.50	2.75	3.25

Source: Central Bank of Cuba (BCC), Interest Rates,
http://www.bc.gob.cu/Español/tasas_interes.asp

Table 5. Interest Rates 2011-2014, Individuals

								Term (months)
Currency	*At Sight*	*3*	*6*	*12*	*24*	*36*	*60*	*72*
CUC	0.50	1.50	2.00	2.50	3.00	4.00	4.25	
USD	0.25	0.50	0.75	1.00	1.25	1.75	1.90	
CUP	0.50	2.00	2.50	4.00	5.00	6.00	6.50	7.00

Source: Central Bank of Cuba (BCC), Interest Rates,
http://www.bc.gob.cu/Español/tasas_interes.asp

In Cuba, microfinance institutions have traditional markets, new markets, and growing credit market segments. Recently created, the real-estate market reported in 2012 over 45,000 home sales, with prices ranging from 5,000 to half a million CUC. The sale of used and new automobiles, authorized by Official Gazette 46 (December 31, 2011, entered into force on January 3, 2014) is highly dynamic with a high rate of return in the sector for cars used as "taxis" although less so for retail sales of private-use vehicles whose prices are inaccessible due to low wages. Moreover, the regulations do not permit Cuban individuals to import vehicles, because only Cuban companies are authorized to import motor vehicles, bodywork and engines, with the prior approval of the Ministry of Foreign Trade and Foreign Investment, although representations of diplomatic missions, consular offices, and international agencies accredited on the island are authorized to import any type of motor vehicle and car parts.

Another productive sector that is a bastion of the Cuban economy and a major destination of credit is the agricultural industry, which, since the publication of Official Gazette 40 (November 21, 2011) has benefitted from the increased credit supply available to private agricultural and livestock producers who had been given land in usufruct in 2008. In the agricultural sector, loans are channeled towards the acquisition of working capital during the planting and crop harvest periods, as well as the purchase and care of livestock, and purchase of inputs and investment in facilities. The government's decision to create a non-agricultural cooperative sector will contribute to making the fabric of new businesses denser, even though the number is limited to 220 non-agricultural cooperatives, of which 126 have already formed, distributed as follows: 110 agricultural and livestock market cooperatives, five transport cooperatives, and 11 construction and home repair cooperatives (Triana, 2013: 3).

Before the financial reforms, capital for private business came from the savings of entrepreneurs, remittances from abroad, and resources obtained through informal financial means, such as loans from family and friends. The opening up of credit from state banks is adding new resources to the private sector by creating institutionalized financial channels, and because these credit institutions are trained to select the most profitable and least risky projects, the hope is to achieve high efficiency in the allocation of resources, which will continue to improve as the country overcomes lagging technology in the banking and financial sector, creates telecommunications infrastructure, and spreads financial culture among the population.

Since these microfinance institutions began to develop, they have processed over 4,000 credit applications in the country. In Havana Province, there were 1,235 applications in 2012 and 1,812 in 2013, and 933 and 1,105 microloans were approved in the same years, respectively, for a total value of six million CUC, mainly destined to financing construction materials.

These financial transformations combine new elements and characteristics that influence the rising demand for microfinance services and products. The first is microcredit, which has grown considerably and could solidify in the short term given its role in the formation of small and medium-sized enterprises, as well as the spread of self-employment. In other words, microfinance and microcredit institutions will play a larger role in the Cuban economy insofar as their spread has a real impact on micro- and macroeconomic performance.

Tax reform, monetary and financial reforms, and the education level of the population, together with other economic, political, and social institutional elements both domestically and internationally (such as the reopening of political relations with the United States), are shaping a proactive economic development model in Cuba, which will feed economic growth (obviously with job creation), bolster monetary and financial stability, and attract foreign investment.

Foreign direct investment

Trade liberalization in Cuba began in the 1980s when the government approved Decree-Law 50, which permitted foreign direct investment in order to boost exports and encourage the introduction of modern technology in select branches of the national economy. In 1995 and 1996, this push, which had attracted 563.4 billion CUC to the island, suffered a setback with the enactment of Decree-Law 77, which established the selective and restrictive admission of foreign investment in economic sectors such as: basic industry (energy, mining, and cement), tourism, construction, light industry, and agriculture (Solorza, 2007: 183). In 1997-2010, foreign investors showed little interest in Cuba. Foreign investment amounted to 442 million CUC in 1998, and 448.1 million CUC in 2010, unable to compensate for the chronically negative current account balance in the balance of payments. Now, the National People's Power Assembly of the Republic of Cuba has approved a new Foreign Investment Law, Law No. 118 (April 2014), to attract foreign capital and complement the more than 300 economic and financial reforms made by the Cuban Communist Party (PCC). In this way, the country is trying to cover the needs that will put the island on the path to growth and development, as China has done, without ceding centralized political control, to revive the economy, expand the domestic market, drive the production of exportable goods, and update its statist model.

In Law No. 118 on Foreign Investment, the National People's Power Assembly establishes a regime of legal facilities, guarantees, and assurances for investors to attract and harness foreign capital. Likewise, it indicates that the destinations of foreign investment may include the diversification and expansion of export markets, access to advanced technologies, import substitution, primarily of food (included in agriculture, the idea is to reduce spending by 2 billion dollars on food imports), the sugar industry, nickel, infrastructure and construction, oil, tourism, the creation of new sources of jobs, capture of managerial methods, linkages to the development of productive chains, and changing the country's energy matrix by exploiting renewable energy sources to preserve the ecosystem and prevent environmental damage. This means that foreign investment is essentially permitted to flow into all economic sectors, except health, education, and the armed forces (Presidencia del Consejo de Estado de la República de Cuba, 2014: 2-3).

In this way, Cuba is updating its foreign investment policy to stimulate foreign investment by authorizing the creation of mixed enterprises (corporations with both national and foreign participation), as well as completely foreign-capital enterprises (corporations with foreign capital and no participation of national investors or individuals), as well as by fostering participation in Special Sustainable Development Zones, which are cutting-edge industrial concentration zones based on technology innovation for exportation, linked to the domestic economy. According to the Vice President of the Council of Ministers, the country needs to attract capital to develop and give momentum to its economy. He has stated that the country needs between two and two and a half billion dollars annually for the GDP to grow between 5% and 7%, which demands an annual investment rate of 20%.

Law No. 118 on Foreign Investment is a strategic tool that offers legal protections and security by guaranteeing that investments shall not be expropriated, “except for reasons of public utility or social interest previously declared by the Council of Ministers,” that investments can be sold, and that “repatriation of earnings is permitted” (Presidencia del Consejo de Estado de la República de Cuba, 2014: 3-7). This regulation includes a special tax regime that provides for “tax exemptions on personal income and customs duties for the importation of equipment and machinery by foreign investors,” partners or mixed enterprises, or parties to contracts with international economic partnerships. It also "exempts them from paying taxes on profits for a period of eight years, which the government may extend." Additionally and exceptionally, it permits foreign investors to be part of non-state management formulas, concretely cooperatives, although the State will retain a control function to prevent the concentration of ownership. This new law that repeals and replaces Law No. 77, Decree-Law No. 165 on Free Zones and Industrial Parks (June 3, 1996), and Agreements No. 5279 (October 18, 2004), No. 5290 (November 11, 2004), and No. 6365 (June 9, 2008) "does not prevent investment in the country from Cuban emigrants," but still stipulates that local workers be hired through a state employment agency, aiming to raise average salaries to above 20 dollars a month (the current average).

The scope of the economic reforms and medium- and long-term prospects

Broadly speaking, it could be said that in the short term, the economic reforms implemented in Cuba have not produced transcendental positive results. The Cuban economy faces structural problems expressed in the low productivity rates of its state enterprises and weak GDP growth, as shown in Figure 2, due to low momentum in the agricultural, industrial, and basic services sectors, including construction and transportation.

Cuba maintains its growth and dependence on the professional services industry, a reason for which it has sought for some time now to counteract the imbalance in the balance of payments with the export of health services and medications. This imbalance is due to high import levels, stagnated nickel production, lower inflows of resources related to tourism (see Table 6), the sale of seafood and citrus fruit, and deteriorating sugar production (see Table 7).

*Economic Commission for Latin America and the Caribbean (ECLAC), Projected Data.
Source: National Office of Statistics and Information (ONEI), National Accounts, Statistical Yearbook 2010 and 2012, Cuba

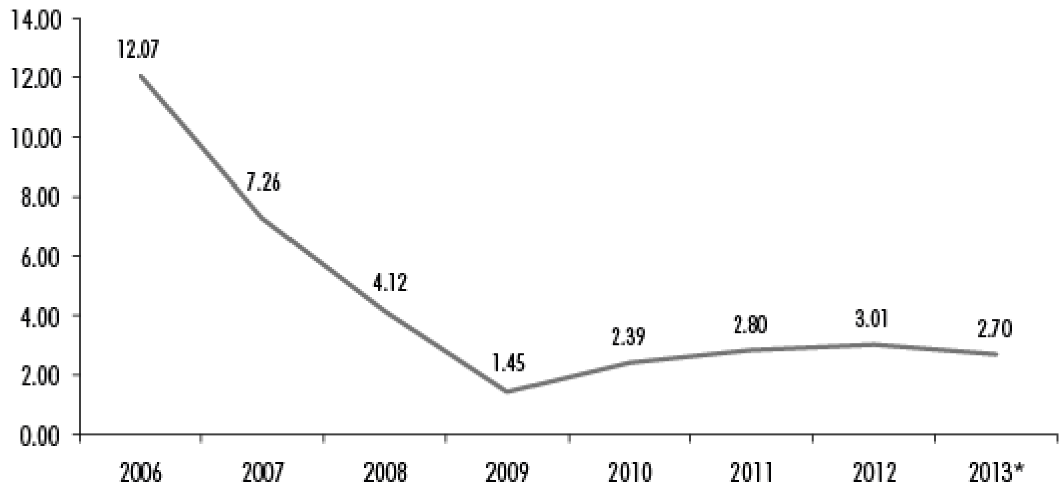

Figure 2. Gross Domestic Product (Annual Rates of Variation)

Table 6. Tourism Indicators

	2006	2007	2008	2009	2010	2011	2012	2013
Visiting tourists (thousands)	2 220.6	2 152.2	2 348.3	2 429.8	2 531.7	2 716.3	2 838.6	2 852.6
Gross tourism revenue (millions of convertible pesos)	2 234.9	2 236.4	2 346.9	2 082.4	2 218.4	2 503.1	2 613.3	2 627.0

*Includes revenue for international tourism and international transport. **Source:** National Office of Statistics and Information (ONEI), Tourism in the Statistical Yearbook 2011, 2012 Edition, and the Statistical Yearbook 2013, 2014 Edition, Cuba.

Table 7. Sugar Production Indicators

	2006-2007	2007-2008	2008-209	2009-2010	2010-2011	2011-2012
Crude sugar production (millions of tons)	1 205.4	1 381.6	1 348.3	1 168.2	1 202.9	1 406.6
Industrial yield (percentage)	9.7	11.4	10.3	10.1	10.4	10.0
Export revenue (millions of pesos)	219.0	193.7	223.0	215.6	256.6	ND

Source: National Office of Statistics and Information (ONEI), Fundamental Indicators for the Sugar Industry in the Statistical Yearbook 2011, 2012 Edition, Cuba.

The economic reforms have not considered the vulnerability of the island to powerfully destructive natural phenomena related to climate change. As such, Cuba has had to survive natural catastrophes and the global 2008 crisis by resorting to the withholding of payments abroad, which has increased its proportion of foreign debt with respect to exports, and resulted in increased government spending, reflected in a rising budget deficit as percentage of GDP, which, although not too significant, as can be seen in Figure 3, in the medium term could continue to rise unless revenue from another domestic and export-oriented economic activity goes up, or investment and financing expand, increasing productivity and the tax base through the creation of companies and jobs (not an inflated workforce and underemployment) with wages above the current average of 20 dollars a month. This will be difficult in light of the island's complicated demographic scenario: 20% of the population is over the age of 60 years old, the island has a low birth rate, and annual migration is above 35,000 people.

Source: National Office of Statistics and Information (ONEI), Statistical Yearbook 2010 and 2012, Cuba.

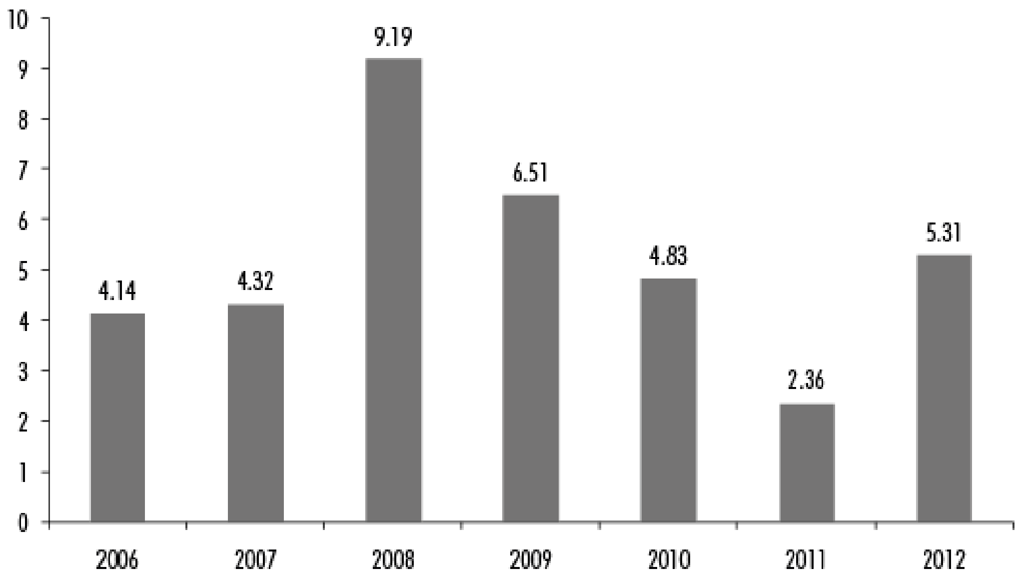

Figure 3. The Budget Deficit (Percentage of GDP)

Analysis of leading economic indicators and the general prevailing conditions in Cuba would help elucidate the State's strategy to "modernize or update its growth and development model" with an emphasis on opening up to foreign investment on a large scale. In this context is situated the deepwater oil exploration by foreign companies (the Venezuelan Pdvsa, the Russian Zarubezhneft, the Spanish Repsol-YPF) in the northeast region of the island, some 320 kilometers off the northern coast from Havana to Villa Clara, where there are sediments with characteristics similar to those of the major fields in the south of the United States, Mexico, the Middle East, and Venezuela. It is in this same zone of the country where the Mariel Port construction is taking place, which in the long term is meant to have capacity to move between 80,000 and one million containers a year, reduce the cost of maritime transport to America and Europe, and create the Mariel Free Trade and Industrial and Zone. This port complex is the largest infrastructure project in the history of Cuba, and opens up the possibility for the country, in light of its geographic location (in the Caribbean basin) to become, in the long term, a point of shipment and transshipment for goods heading to other countries. Mariel Port could provide docking for the large Post-Panamax ships, which transport more than 12,000 containers and would have previously crossed the Panama Canal. Investment to carry out this project has, up until now, come from the government of Brazil, which has financed 75% of the works (600 million dollars), as the number two trading partner of Cuba in Latin America, behind only Venezuela.

The most remarkable short-term results of the more than 300 economic and financial reforms undertaken in Cuba include the granting of 2,000 microloans in 2012 and 2013, the expansion of microfinance institutions and self-employment, and progress of 45 km^2 out of a total expected 400 km^2 in the construction of Mariel Port, as well as 16 km of a double rail line running from Havana (Calle 100 and Boyeros) to Mariel Port.

In Cuba, medium- and long-term expectations surrounding the potential to achieve great results derived from the economic reforms (structural reforms) are considerable. It is expected that the government will conclude the currency unification process and come to agreements for investment proposals in diverse sectors on behalf of major enterprises from Latin American countries, such as Brazil, Mexico, Argentina, Chile, and the Dominican

Republic, as reported by the Office of the Special Development Zone (ED); small and medium-sized enterprises will use cutting-edge technology to create productive chains; the construction of the Mariel Port and the Free Trade and Industrial Zone will be finished; and the U.S. will repeal its trade, economic, and financial embargo against the country. If these projects alone were to become reality, employment options would skyrocket diametrically (in Mariel Port and the related Free Zone, forecasts point to creating 30,000 jobs), incomes would rise, and the standard of living for the Cuban population would be improved.

Conclusions

In Cuba, the social pact built by the Fidel Castro administration, with a close relationship between the government and its people, remains and still constitutes, despite budgetary adjustments in the services sector and job creation, a strong state commitment to providing education and healthcare, and keeping unemployment low. However, the relationship between the State and society lends some certainty to the implementation of a set of economic, legal, monetary, and financial reforms led by the State since the 1990s, when the Cuban economy began to deal with the entrenchment of its structural problems, reflected in a falling GDP, which obliged it to make decisions oriented towards undertaking economic policy changes. This situation has given rise to a slow and complex economic and institutional transition that, in the long term, has the potential to crystallize into full reinsertion into the globalized world.

As external economic pressures, the recrudescence of the U.S. trade, economic, and financial embargo, the repayment of foreign debt, and the loss of international economic aid have obliged Cuba—an economy historically dedicated to the exploitation, cultivation, and exportation of commodities and beverages such as nickel, sugar, fish, tobacco, and rum—to constantly adjust its growth levels and standard of living for the population in light of continuous exposure to deteriorating terms of exchange, Raúl Castro's administration has tended to adopt economic and social policy guidelines compatible with the separation of state and business functions, the reorganization of the State, the creation of various special development zones, monetary and financial reforms, the encouragement of private investment, and particularly, the sale of lands and housing, which imply the existence of private property rights.

As such, the most recent fiscal reform (2012) added in taxes to be levied on personal income, profits, the transfer of assets, inheritances, and the private ownership of lands and homes. However, foreign direct investment is exempt from paying taxes on profits and personal income and is permitted to repatriate earnings. The monetary and financial reforms have been targeted towards controlling inflation and ending the dual currency system, which consists of the convertible Cuban peso (CUC) and the Cuban peso (PUC), creating a vast network of microfinance institutions in order to support self-employed workers and reduce high poverty levels through microloans.

It is essential for the Cuban government to make its economic growth and domestic development policies compatible with its economic, political, fiscal, monetary, and financial reforms. On the whole, economic and social transformations must be correlated with the absorption and sectoral allocation of foreign investment, so that this investment will be stable and play a positive role in productive sectors, contributing to the rise of productive chains.

Likewise, the government must control the expansion of microcredit to reduce the risk of defaults and spiraling poverty levels. In general, it will be necessary to ensure that short- and long-term economic plans are aligned before Cuba continues along its path to liberalization and rejoining the global economy.

Bibliography

Aoki, Masahiko (1995), "An Evolving Diversity of Organizational Mode and its Implications for Transitional Economies", *Journal of the Japanese and International Economies*, vol. 9, no. 4, San Diego Academic Press, December, pp. 330-353.

Banco Central de Cuba (BCC) (2011), "Tasas de Interés de Referencia para el Sistema Bancario", Press Release, December 20, 2011 (Consulted April 16, 2015), available at: <http://www.bc.gob.cu/Espanol/tasas_interes.asp>

Bateman, Milford and Ha-Joon Chang (2012), "Microfinance and the Illusion of Development: From Hubris to Nemesis in Thirty Years", in *World Economic Review*, Bristol U.K., vol. 1, pp. 13-36.

Coase, Ronald (1960), "The Problem of Social Cost", *Journal of Law and Economics*, no.3, Chicago University Press, October, pp. 1- 44.

Comisión para América Latina y el Caribe (CEPAL/ECLAC) (2000), *La economía cubana, reformas estructurales y desempeño en los noventa*, Mexico, Fondo de Cultura Económica.

Kaufman, Susan (1996), "Ley Helms Burton y el Embargo Estadounidense contra Cuba", consulted June 15, 2014, available at: <codex.colmex.mx:8991/exlibris/aleph/a18_1/apache_media/NVIURRSN5BI-M86C6HF4E2SPKFYYI6S.pdf>

Lamrani, Salim (2011), *État de siège. Les sanctions économiques des États-Unis contre Cuba*, Paris, Editions Estrella.

Oficina Nacional de Estadísticas e Información (2014), "Cuentas Nacionales", in *Anuario Estadístico 2010 and 2012*, ONEI, Havana.

______ (2014), "Empleos y Salarios", in *Anuario Estadístico 2011, Edición 2012 y del Anuario Estadístico 2013*, ONEI, Havana.

______ (2013), "Finanzas", in *Anuario Estadístico 2010 y 2012*, ONEI, Havana.

______ (2012), "Turismo", in *Anuario Estadístico 2011*, ONEI, La Havana.

______ (2012), "Indicadores Fundamentales de la Industria Azucarera", in *Anuario Estadístico 2011*, ONEI, Havana.

Partido Comunista de Cuba (2011), "Lineamiento de la Política Económica y Social", VI Congreso del Partido Comunista de Cuba, July 18, 2011 (Consulted June 25, 2014), available at: <http://www.juventudrebel-de.cu/file/pdf/.../lineamientos-politica-partido-cuba.p...>

Presidencia del Consejo de Estado de la República de Cuba (2014), "Decreto- Ley Número 118 Ley de la Inversión Extranjera", *Gaceta Oficial de la República de Cuba*, año CXII Edición Extraordinaria no. 20, Havana, April 16, 2014.

Sachs, Jeffrey and Wing Thye Woo (1994), "Experiences in Transition to a Market Economy", in *Journal of Comparative Economics*, Massachusetts, Harvard University, vol. 18, no. 3, June, pp. 271-275.

Solorza Luna, Marcia Luz (2007), "La economía cubana en la globalización mundial: ¿transición con rumbo?", *Problemas del Desarrollo*, vol. 38, no. 151, Mexico, UNAM-IIEc, October-December, pp. 177-196.

Suárez, Roberto (2014), "Trabajo por cuenta propia, crece y se valida como opción de empleo en Cuba", *Cuba Debate*, March 19, 2014 (Consulted July 15, 2014), available at: <http://www.cubadebate. cu/especiales/2014/03/19/trabajo-por-cuenta-propia-crece-y-se-valida-co-mo-opcion-de-empleo-en-cuba/#.U-1i5MWSzSg>

Triana Cordoví, Juan (2013). "Microfinanzas y microcréditos en Cuba", in *Desde la Isla*, no. 18, July 23, 2013 (Consulted August 20, 2014), available at: <http://www.DESDELAISLA.ORG>

United States Code (1992), "Cuban Democracy Act (CDA), Title 22, Foreign Relations and Intercourse Chapter 69", consulted June 15, 2014, available at: <https://www.treasury.gov/resource-center/sanctions/ Documents/cda.pdf>

Vidal Alejandro, Pavel and Omar Everleny Pérez Villanueva (2013), "La reforma monetaria en Cuba hasta 2016. Entre gradualidad y 'big bang' ", Foreign Policy-CIEI-CEEC-University of Havana, December 1, 2013 (Consulted August 11, 2014), available at: <http://www.brookings.edu/~/media/research/files/papers/2014/01/monetary%20reform%20cuba%202016%20alejandro%20villanueva/monetary%20re-form%20cuba%202016%20alejandro%20villanueva.pdf>