

The Cuban Economy: Private, Cooperative and Underground



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Objectives:

- To analyze and evaluate Cuba's policies towards the private and cooperative sectors.

■ Main Argument:

1. Past policies have wasted a remarkably rich resource, namely the entrepreneurship, ingenuity, creativity, energy and talents of Cuban citizens;
Perhaps Cuba's most dysfunctional area of economic policy;
Generated a huge underground economy.
2. Liberalization in 1994 and 2010 - 2018 generated positive results with major net benefits and can be made compatible with equity considerations.
Current (2018-2019) back-sliding will have negative effects
3. Further liberalization is desirable, but with caution regarding income distribution and foreign ownership and control.

Outline:

I. Entrepreneurship

A. The Cuban Case

II. Cuban Policy towards Small Enterprise

III. Controls and Prohibitions,

1961-1993;

1993-2010

The Underground Economy and State Control

IV. Liberalization Measures, 2010-2019

V. Further Appropriate Liberalization Measures

VI. The Cooperative Sector

VII. Summary and Conclusion

But First:

Cuenta Propismo: Some Visual Perspectives



Photographer by the Capitolio



Photographer, Parque Central



Rural Transportation



Urban Transportation: Bicytaxis



Repairing a Bicytaxi





Bicytaxi Mechanic's Shop, 2008



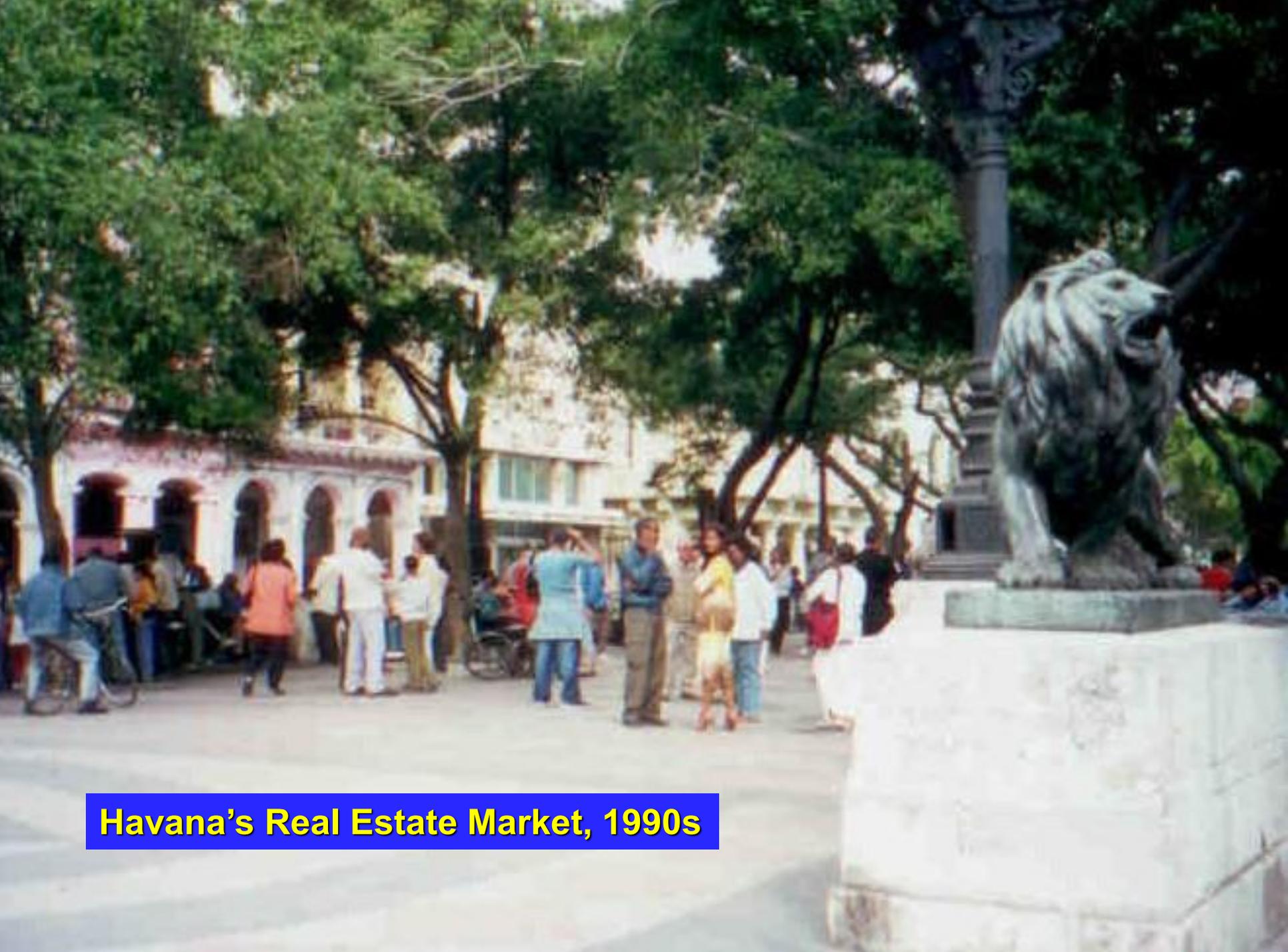
**Hat and Basket Weaver, and Vender of
Santeria Items, Havana, 1994**



**Art Market, circa 1996
Plaza de la Catedral**

Havana Fisherman Transporting his Craft





Havana's Real Estate Market, 1990s

Mercado Agropecuario, Cuatro Caminos



**Area Estatal,
Mercado Agropecuario,
Cuatro Caminos**



Artesan Market, Malecon



Barrio Chino, 2008





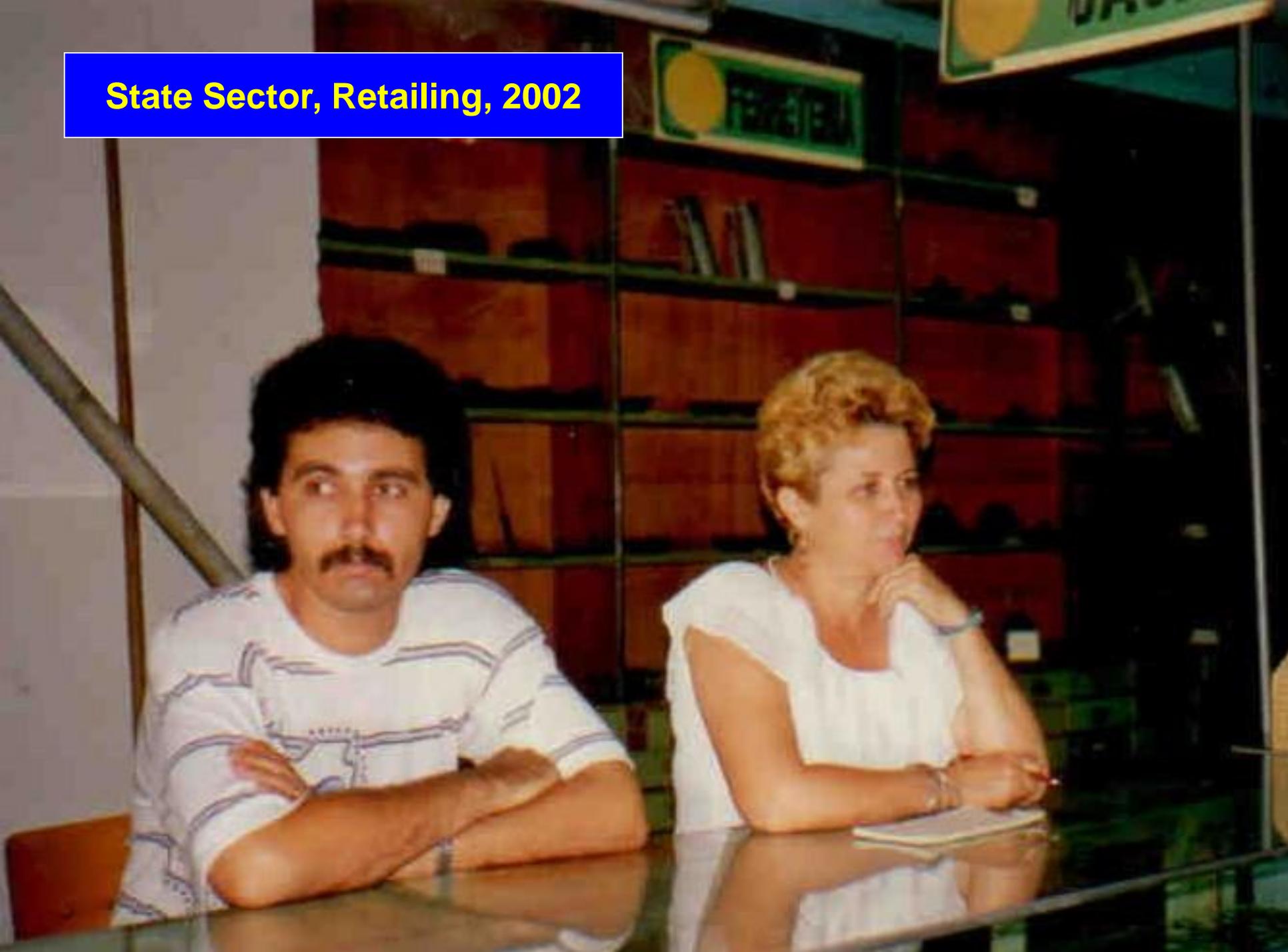
New Paladar, February 2011





State Sector Retailing, 1968

State Sector, Retailing, 2002



State-sector Retailing, 2007



A woman with dark hair, wearing a black and white patterned top, sits behind a counter in a retail store. The counter is painted light blue and has the Spanish text "Gracias Fidel por todo lo que nos das.." written on it in brown. In the background, there is a sign that says "Fidel's 2005" with a blue ribbon graphic. To the right, a green chalkboard and a metal scale are visible. The store has a rustic, brick-like wall and shelves with various items.

Gracias Fidel por todo lo que nos das..

I. Entrepreneurship: the Vital Resource

Entrepreneurship: The Central Ingredient for Human Development

- Brings together all of the resources, inputs, and individuals necessary to implement project.**
- Relevant for politics, academia, religion, music, sports, or almost any area of human endeavor.**
- Especially relevant for the economy**

The Entrepreneur

- Perceives and seizes an opportunity for the achievement of an objective,**
- Visualizes and plans how the objective can be achieved,**
- Does everything necessary to implement the vision, carry out the project, and fulfill the opportunity envisaged.**

Entrepreneurship in Cuba:

A Counter-intuitive and Ironic Paradox:

**Almost five decades of Castro's
Revolutionary Project have produced**

Not the “New Man”

but

a “Nation of Entrepreneurs.”

Why?

1. Rationing System (since 1962) required people to find opportunities to buy and sell;
2. Central Planning System: imperfection and unworkability require managers to improvise solutions, buying and selling inputs etc. “outside the plan”
3. Shortage economy since 1962 also required finding alternate sources of goods and services;
4. State Sector inadequacies under “Special Period” after 1994 require people to resolve their own problems

“Luchar, Resolver, Inventar, Conseguir”

Entrepreneurship in personal life can co-exist with apathy in other areas.

Note: Distributional - Work ethic in the state sector

But:

Entrepreneurial talents have been expended on low-level survival activities.

A supportive policy environment would permit a flowering of innovation, creativity, ingenuity, energy, and productive entrepreneurship.

**Result: Rapid Economic Diversification,
Expansion, Improvement & Innovation;
Improved Quality of Life**

The Range of Enterprises Considered Here:

- 1. Current Legal Micro-Enterprises (*Cuenta Propistas*)**
(Around 570,000 legally employed therein,
plus some +/- ?? 100 thousand undocumented, often part-time
and family members employed.)
- 2. Unrecognized (or underground) Enterprises**
A guess: 100,000 full-time; 300,000 employed ???
- 3. Cooperative enterprises**

Type of Economic Activity	General Character
A. HOUSEHOLD ECONOMY: Non-monetized activities within the home or among neighbors	<ul style="list-style-type: none"> - Child rearing activities..... - "Do-it-yourself" activities - Cooperative work
B. FORMAL ECONOMY: Legal goods and services; within state's regulatory framework	<ul style="list-style-type: none"> -- private enterprises - state enterprises and activities - ,joint ventures
1. Licensed "Self-Employment"	<ul style="list-style-type: none"> - Registered "Cuenta-Propistas"; - Small Farmers
2. Formal Enterprises: Joint Ventures, State Enterprises, Formal Cooperatives	-Tourism; Minerals; Sugar sector etc. Etc.
C. The Informal Econopmy; Under-ground Economy in Cuban case	Legal goods and services; carried out illegally or "unauthorized" by state
1. "Legitimate Underground Activities"	(As above)
2. Within registered self-employment activities	- Unauthorized sales- Unauthorized dollar activities
3. Underground activities operating within State Firms	- Private payments to state employees; Under-the counter sales; Illicit private enterprises
4. Black Markets:	<ul style="list-style-type: none"> - Under-the-counter sales in state retail outlets - Sales of products outside the state system
D. CRIMINAL ECONOMY: Unlawful activities, carried out illicitly	- Theft; Sale of jobs; Sale of stolen goods; Personal use of public property; Drugs, ...

II. Policy towards Small Enterprise

A. Nationalizations:

- **1961-1963, medium-size & large, foreign and domestic enterprise nationalizations**
- **1968, The Revolutionary Offensive**
 - **Castro's rationale:**
 - **Excessive incomes;**
 - **Breeding ground for egotistical attitudes;**
 - **Low quality goods and services**
 - **Illegal input sources.**
 - **Some 56,0000 firms nationalized**

Consequences of Nationalizations:

1. Bureaucratic control replaced entrepreneurs operating under markets;
2. State sector could not replace or run the nationalized enterprises adequately
3. Product quality, quantity and diversity deteriorated
4. True living standards were impaired
5. Some enterprises pushed underground;
Underground economy expanded
6. **Theft** from state sector and **illegalities** become the norm
7. General economic sclerosis and stagnation was institutionalized
8. Urban landscape became commercially dead.

B. Enterprise Liberalization, 1993

- **Caused by**

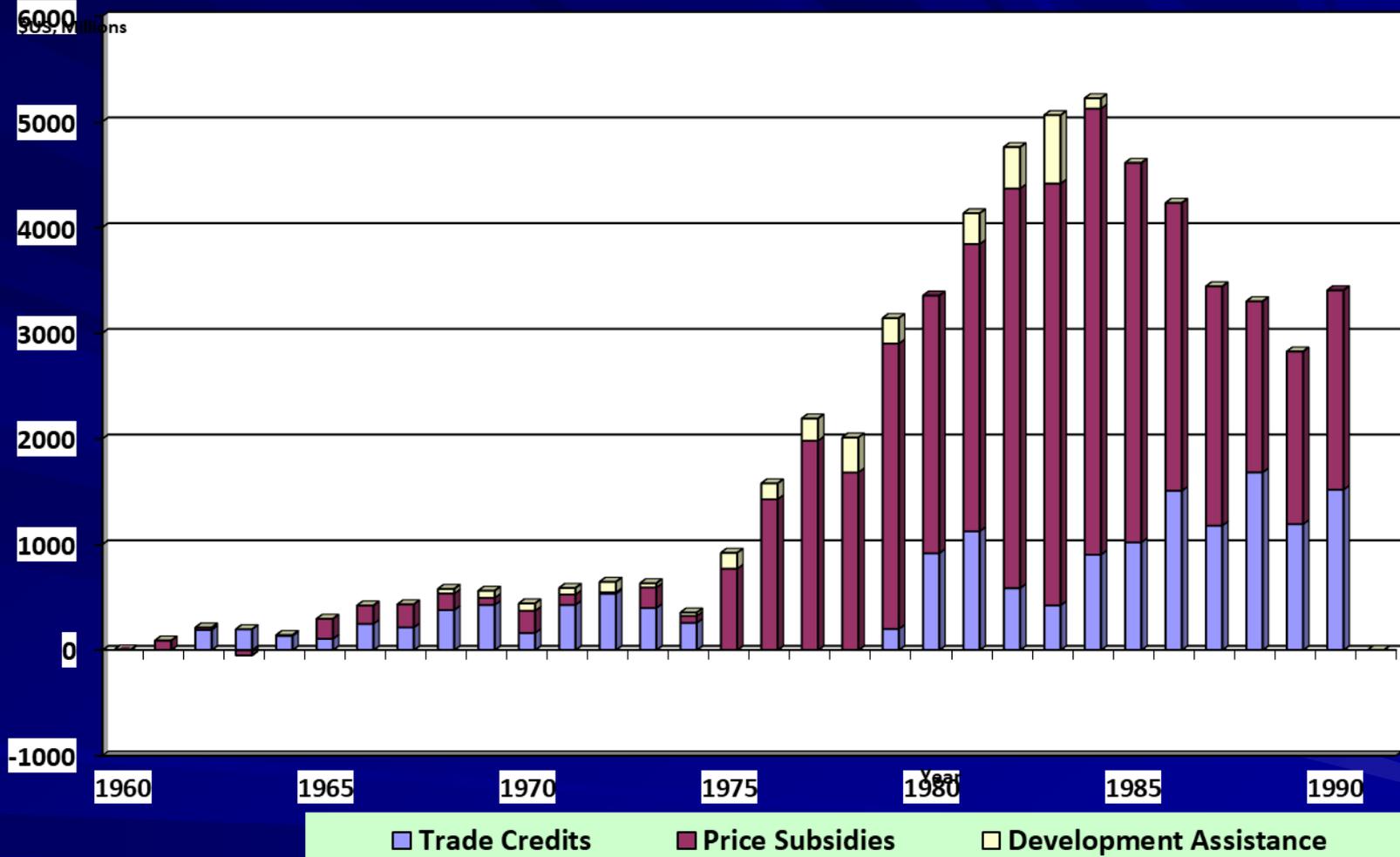
- **economic meltdown due to termination of Soviet assistance;**
- **Non-sustainability of central planning system**

- **Forced by circumstances:**

- **State sector unable to provide for people's survival**

- **Government ratified what people were already doing illegally but of necessity**

Economic Assistance from the Soviet Union to Cuba, 1960-1990 (Millions of US Dollars)

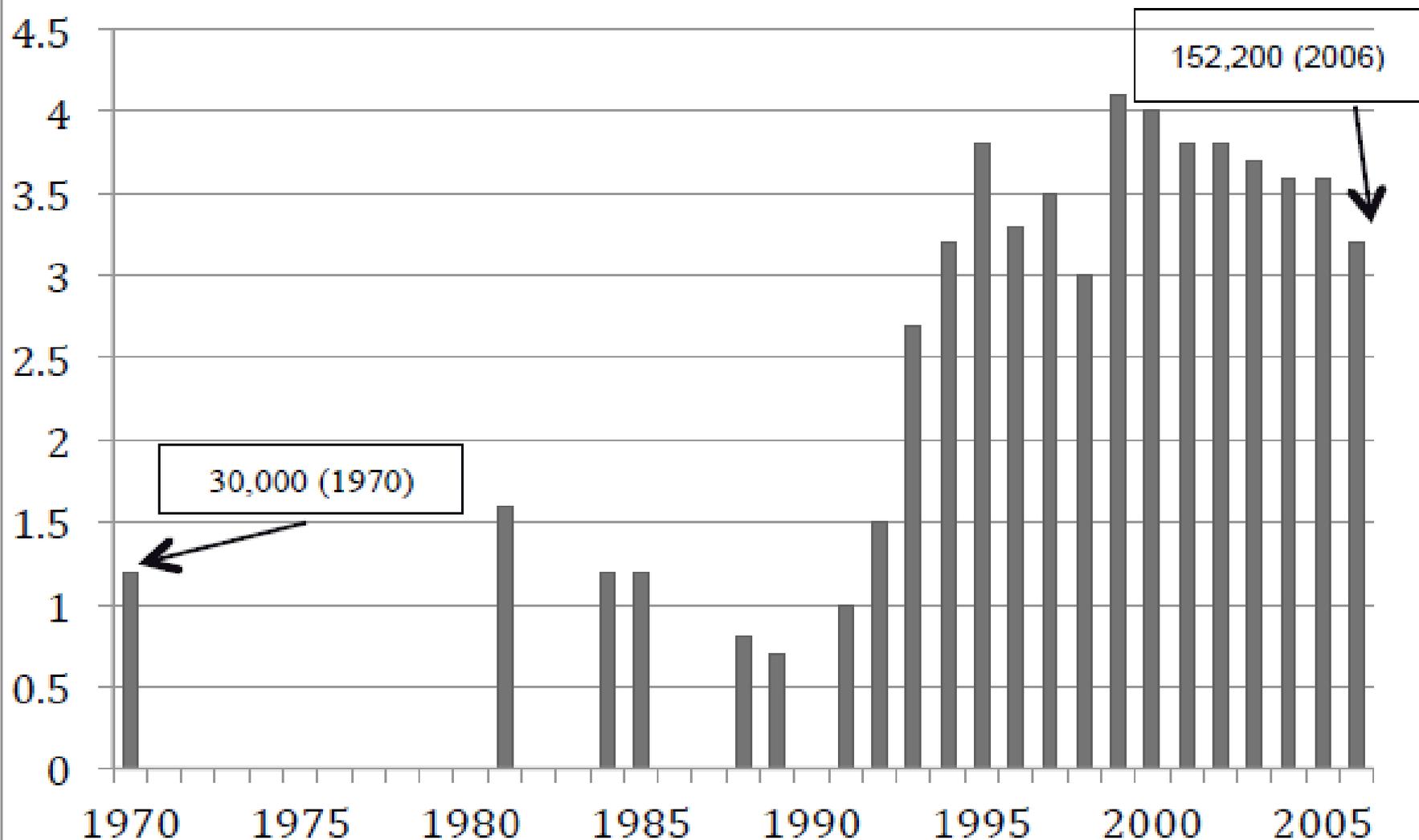


Source: Based on LeoGrande and Thomas 2002: 340-341.

Results:

- People's day-to-day life was enhanced greatly
- Fourfold increase in legal TCP enterprises (see chart)
- Enterprises spring up from underground
- Productive employment creation
- Quality, quantity, and diversity of goods and services improve
- Foreign exchange earnings and savings
- Urban areas spring to life

Self-Employment in Cuba as Percentage of Total Employment, 1970-2006



Source: ONE: Anuario Estadístico de Cuba, various issues

Income Implications of TCP Liberalization:

- Domestically Oriented Enterprises:
 - Simple G & S for low income consumers,
 - generate somewhat higher incomes, but often not significant
- Tourist sector TCPs: high incomes
 - (*Paladares* and B&Bs; Some Artesans and Musicians
- Real Incomes for Party elite / *nomenklatura* continue to be high]

III. 1995 to 2010: Limitations and Controls were intensified

- **Castro lamented decision to liberalize in 1994**
- **Intensified controls in 1995**
- **Objective:** - **Constrain growth of private activity;**
 - **Protect state enterprise**
 - **Contain higher incomes of sector**

A. Controls and Prohibitions:

- 1. Restrict all activities except those specifically permitted**
 - e.g. Prohibit all professional self-employment
 - Prohibit 41 of the initial 156 legalized activities
- 2. Restrict by Licensing (See Chart)**
- 3. Onerous Taxation (See Charts)**

The Tax Regimes for Cuban Micro-Enterprise and Foreign Enterprise Operating in Joint Ventures

	Micro-Enterprise	Joint Ventures
Effective Tax Rates	May Exceed 100% of Net Income	30% of Net Income (50% for mining and petroleum)
Effective Tax Base	90% of Gross Income; [10% allowable for costs]	Net Income after Deduction of Costs
Deductibility of Investment	Not Deductible from Taxable Income	Fully Deductible from Taxable Income
Lump-Sum Taxation	Up-Front “ <i>Cuota Fija</i> ” Tax Payments	None
Rebates for Tax Overpayment	No Rebates for Over-payment	Not Applicable
Tax “Holidays”	No	Yes
Profit Expatriation	No	Yes

Source: The Author

III. 1995-1996 - 2010: Limitations and Controls, Continued:

3. Prohibitions

- (a) No access to credit;**
- (b) No access to foreign exchange or imports
(except through state “TRD” stores)**
- (c) No advertising**
- (d) No intermediaries**
- (e) Limits on numbers of employees;**
- (f) Innumerable petty restrictions (see chart)**

4. Negative Political and Media Environment

**DECREE LAW 174: MICRO-ENTERPRISE RULES, CONTRAVENTIONS,
FINES, AND PUNISHMENTS**

CONTRAVENTION

Article 3 Contravention of Micro Enterprise Regulations

1. Exercise of unauthorised activity
2. Exercise of legal activity by unauthorised person
3. Violations of regulations in a legal activity:
 - (a) more than 12 places (seats) in a private restaurant
 - (b) sale of fish, seafood or beef in a private restaurant
 - (c) sales in \$US when not authorised
 - (d) sale of alcohol without accompanying food sales
 - (e) use of seats, benches or tables in street vending
 - (f) use of other location than one's home
 - (g) inadequate receipts for legal purchase of inputs
 - (h) use of family labour without licenses
 - (i) exhibiting unauthorised films in video rooms
 - (j) sale or use of protected flora or fauna
4. Use of one's home for someone else's micro enterprise
5. Use of intermediaries or specialized sellers
6. Acting as an intermediary for other's products
7. Non-payment of rental fee for market space
8. Sales to state entity without specific permission
9. Safety violations
10. Hiding or falsifying information from authorities
11. Failure to show registration documents at any time
12. Employment of persons under 17 years
13. Acting as a wholesaler to other micro enterprises
14. Sales or exhibition of legal products by sellers of other products
15. Organization of producer coops or associations unless specifically authorised
16. Resale of industrial products purchased in state sector
17. Use of prohibited materials or inputs
18. Operation in other provinces from that authorised
19. Failure to update information provided to *Registros de Trabajadores de Cuenta Propia*

B. Consequences of 1995-2010 Limits on Small Enterprise for Cuba

- Potential positive effects all reduced;
- Product quality & diversity limited;
- Efficient job creation limited;
- Activities forced underground or into extinction;
- Small size produces inefficiencies for enterprises

[Wastes Human, Capital and Natural Resources]

Consequences of Limits on Small Enterprise, continued:

- **Restricted Entry** limited competition & results in higher prices and inefficiencies
- **Contempt for the law** is promoted by silly restrictions
- A **culture of non-compliance** and illegality was promoted
- Innovation, High-Tech and Low-Tech, was effectively blocked
- Day to day life, more edifficult

New Strategy, under Raul Castro, 2010-2016:

1. First: downsize the state sector

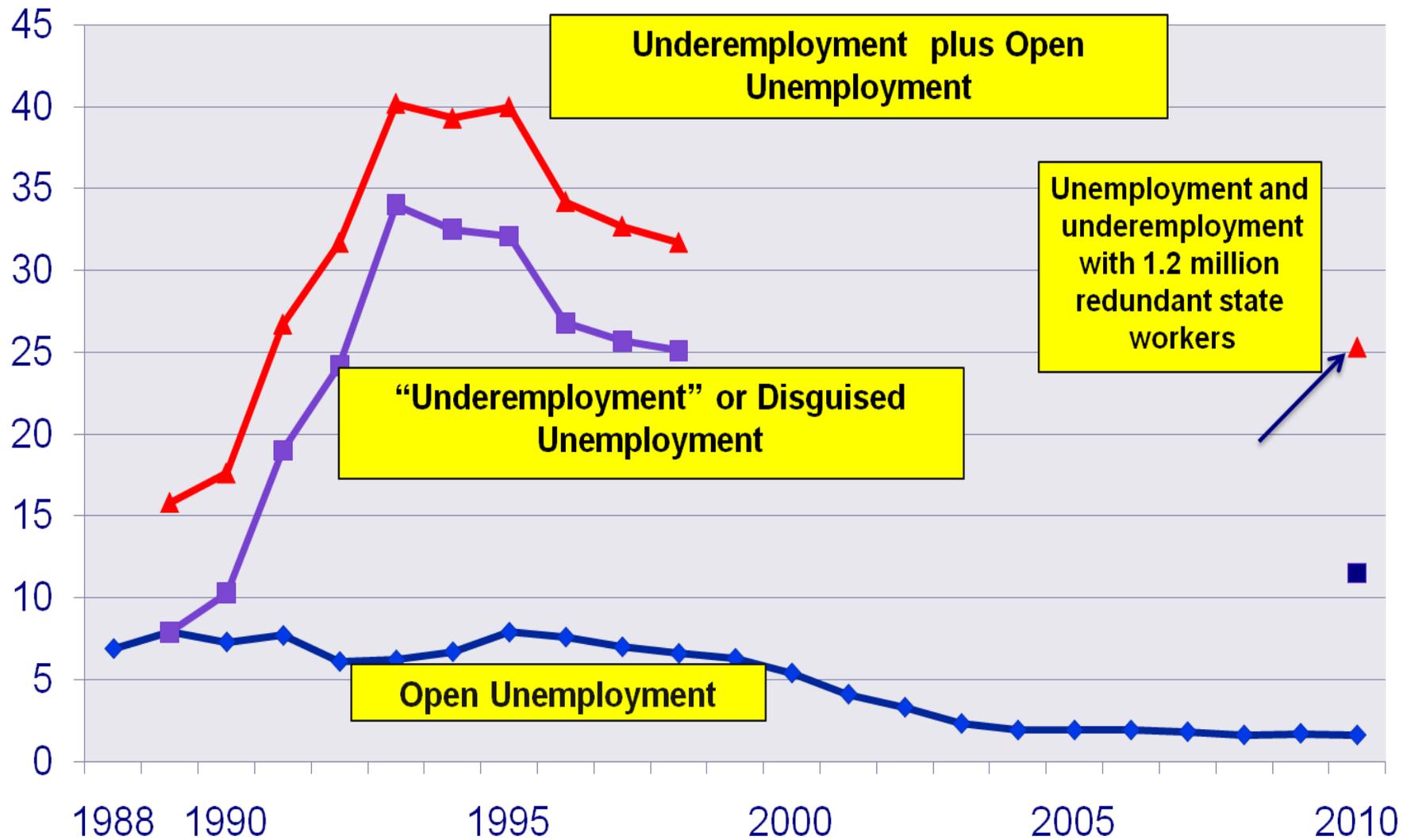
Lay off redundant workers;

2. Second, re-absorb displaced workers in the self-employment and cooperative sector;

Shock Therapy? Ultra-Neo-Liberal?

The old approach was not working, despite Fidel's September assertions;

Unemployment and Underemployment in Cuba, 1988-2010



Source: Carmelo Mesa-Lago: "Convirtiendo el Desempleo Oculto en Visible en Cuba" Espacio Laical, Havana Cuba. And Comisión Económica para América Latina y el Caribe (CEPAL). 1997, 2000. *La Economía Cubana: Reformas Estructurales y Desempeño en los Noventa* (México DF: Fondo de Cultura Económica, 1ª y 2ª ediciones).

An Amazing Reversal of Fortune:

***Cuenta-Propistas* were no longer stigmatized outcasts but have become the designated saviors of the Cuban economy!**

Key Question:

Could the micro-enterprise absorb up to 1,800,000 apparently redundant state sector workers and rescue the Cuban economy?

2. Policy Changes in 2010 towards Micro-Enterprise:

- a) **Range of activities:** a small increase
- b) **Regulatory framework:** some relaxation
- c) **Tax regime:** minor change, and continuing rigor
- d) **Licensing:** significant liberalization
- e) **Media and political environment “de-stigmatized”**

Conclude: Some improvement but still minor

(a) Range of activities:

- **178 finely defined activities allowed;**
 - **Compared with 157 after 1993;**
 - **Then reduced by 40 in 2003**
 - **Includes 16 minor activities in Historic Old Havana**
 - **Minor increase from pre 2005**
 - **Anything not specifically permitted is prohibited**
- **Mainly low-tech activities;**
- **Virtually all professional self-employment remains prohibited;**

(b) Regulatory Framework: “From 12 to 20 chairs”

Definition of Infractions and Penalties

Virtually unchanged; See Decree-Law 274. September 30, 2010

But license removal and confiscation of equipment and products is eliminated

Prohibitions: some Relaxation

- (a) Access to **credit** were to be possible; Not done
- (b) Some Improved access to purchased inputs, in future
- (c) Some minor restrictions relaxed: 12 to 20 *Paladar* chairs;
- (e) Increased limits on hiring of employees;
- (f) Petty restrictions continue,

Prohibitions: some continued:

- (a) No intermediaries
- (b) No advertising
- (c) No reasonable access to foreign exchange or imports

(c) Tax Regime: Complex, Punitive, Dis-incentivating

For 91 small-scale activities ,

“Simplified Formula” can be used: up-front monthly payments

For larger enterprises: Four Taxes:

1. Sales Tax on Goods and Services for 87 of the 178 activities (10% of Gross Revenues)

2. Tax on Hiring of Workers

3. Social Security Tax

4. Income Tax:

Tax rates: from 25% to 50%

Tax Base: 60% to 90% of Gross Revenues

Effective rate can exceed 100%

Evaluation of New Tax Arrangement

1. Highly **complex** for the **87** larger types of firms;
2. High “effective taxation” rate will **promote non-compliance**
3. Tax on hiring workers will **discourage hiring** and legal job-creation
4. Complexity and high rates will **discourage underground enterprises from becoming legal**
5. **Enterprise “Stunting”** will continue: expansion and economies of scale discouraged or prohibited

Additional Positive Changes March 2011:

- **Broadened eligibility for self employment:** non-retired or non-disabled may obtain licenses
- **Rental of facilities** from citizens or the state is easier
- **Sales to state entities** is now possible;
- Use of **banking** facilities and bank credit will be possible;
- **Cooperative ventures** are now encouraged (taxis, beauticians)

Could the Microenterprise and Co-op sectors generate 1.2 million new jobs by Dec. 2012?

The positive side:

1. Stigmatization reversed:

from outcasts to heroes of the economic recovery

2. **Licensing liberalized** will be helpful;

3. Small increase in permitted activities;

4. Tax change: **increased deductibility of costs** from gross revenues for taxes has for some activities;

5. Rental of facilities from citizens or the state is easier
6. Regulations eased somewhat;
7. **Harsh punishments for infractions are cut**, though fines remain;
8. Use of banking facilities and bank credit will be possible;
9. Improved access to inputs perhaps in future

On the Negative Side:

1. **Heavy taxation continued:** firms will remain underground;
2. **Tax on hiring workers** will discourage job creation;
3. **Narrow definition of legal activities** will limit enterprise and job creation;
4. **Exclusion of high-tech and professional activities** block development of knowledge-intensive enterprises and wastes the training of the highly educated
 - Innovation throughout the economy blocked
5. Some **bizarre restrictions** and prohibitions remain

6. Restrictions on hiring workers remain

Stunting of enterprises will prolong inefficiencies

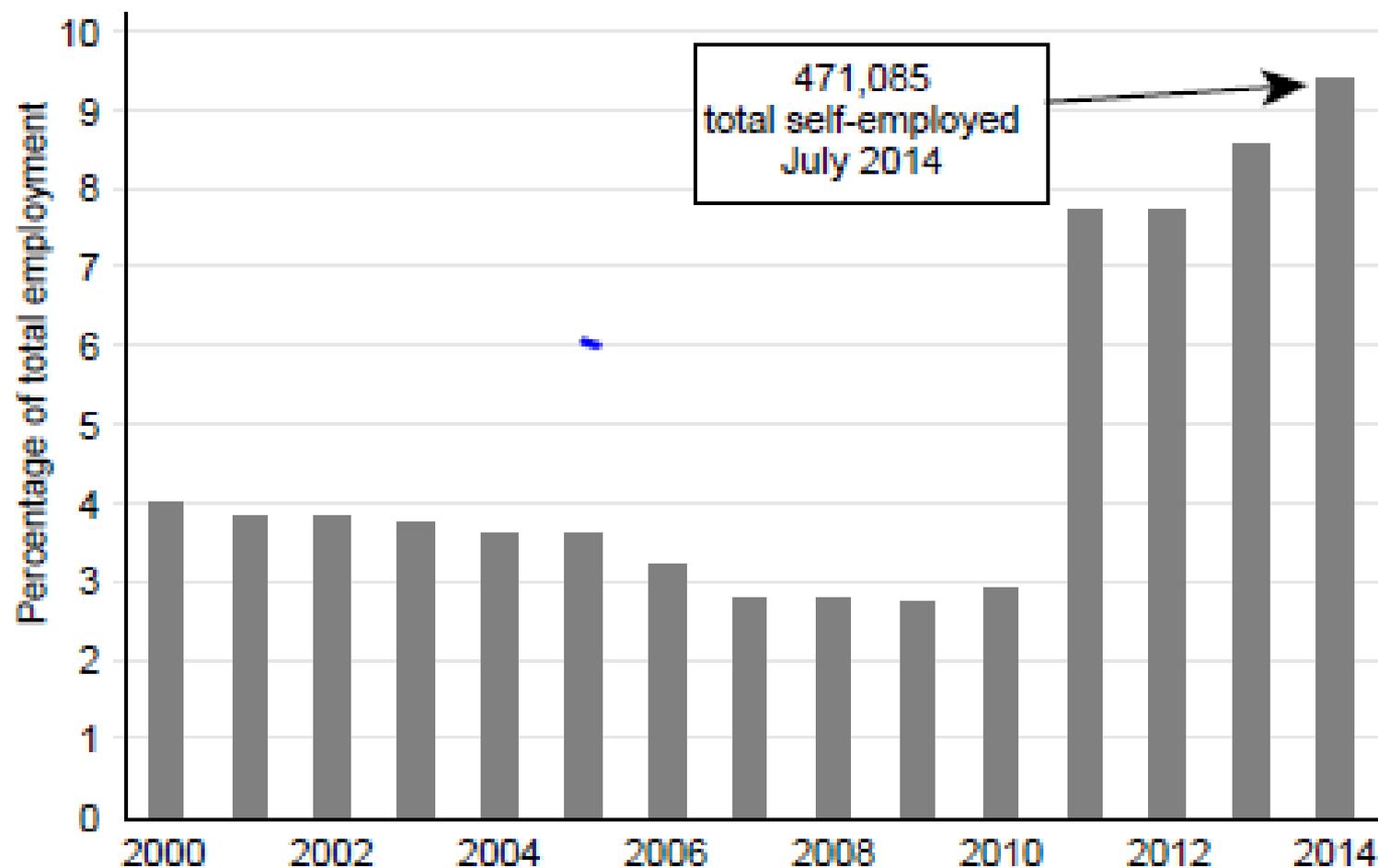
Disincentives to legalization of underground activities continue

Contempt for the Law and non-compliance is promoted by continuation of apparently frivolous restrictions

III. Results?

- Expansion of Small Enterprise and **job creation was too slow** to absorb 500,000 by March 1, 2011
 - 171,000 new licenses by March 10, 2011
- Proposed **shock therapy re employment was too brutal to be implemented:**
- **Firing of workers (500,000 by March 31) was postponed; minimal lay-offs so far.**

Figure 5.5: Non-Agricultural Self-Employment as a Percentage of Total Employment, 2000-2014



Sources: ONE, *Anuario Estadístico de Cuba*, Various Issues; *El Nuevo Herald*, July 2013; *Cubadebate*, March 19, 2014; Manguela 2014.

Additional measures Liberalizing Restrictions on Small Enterprise , May 27, 2011

Objective : facilitate the expansion of the small enterprise, creating new jobs to absorb workers to be declared redundant in the state sector

- 1. *Paladares* expand their capacity from 20 to 50 chairs (previously 12)**
- 2. Loss-making state enterprises may be rented to self-employed individuals**
- 3. The hiring of up to 5 workers has been extended to all self-employment activities.**
- 4. The “minimum employment requirement” whereby for purposes of paying a tax on each employee a minimum number of employees were required, has been dropped.**

Additional measures Liberalizing Restrictions on Small Enterprise, continued

- 5. Exemption on paying employee tax has been granted for the rest of 2011.**
- 6. Some additional new activities have been designated for self-employment;**
- 7. Monthly tax payments have been waived for taxi and bed and breakfast operators for up to three months while they repair their vehicles or rental facilities.**
- 8. Up-front Licensing Tax for bed-and breakfast operators has been reduced for the rest of 2011 from 200 to 150 pesos or convertible pesos**

Relatively little policy change, 2012-2019;

But small enterprise employment increased significantly peaking at +/- 580,000 in 2016

Policy reversals and slowdowns under current President contribute to some shrinkage in 2017

V. Policy Measures for Further Liberalization

1. **Liberalize Licensing:** Let anyone and everyone open a small enterprise

DONE

2. **Permit All Types of Self-Employment, including Professional and High-Tech**

While maintaining state medicine and health systems intact.

Not Done

Policy Measures, Continued

3. Raise the limit on employees **In Progress**
4. Provide legal sources for the purchase of Inputs **In Progress**
5. Permit Access to Imported Inputs **In Progress**
6. Eliminate silly and vexations restrictions; **In Progress**
7. Make Microenterprise Taxation Simpler and Fairer **Not Yet**
8. Establish **Micro-Credit** Institutions **Not Yet**

Policy Measures, Continued

9. Legalize “Intermediaries”

Not Yet

(permitting specialization between producers and venders)

10. Permit Advertising

Not Yet

11. Legalize Markets for Housing, Automobiles and Durables

In Progress

12. Establish a “Ministry for Small Enterprise”

Not Yet

13. Cease the Media and Political Campaigns against Small Enterprise

Some modification

14. Build the Credibility of Public Policy

[Currently the state and public ploicy are seen, correctly, as hostile forces that want to limit if not eliminate small enterprise]

Only modestly

Conclusion:

- Liberalization of the regulatory framework and tax regime for small enterprise is vital for Cuba and its citizens
- Relaxation of restrictions in 2010 and 2011 is in the right direction;
- Major new measures are desirable, for the following reasons:

Impacts of Small Enterprise Liberalization:

1. Increase in legal TCP enterprises
Leading to Increased competition, lower prices, lower incomes in TCP sector
2. Productive Job Creation & Income Generation
3. Improvement of Quality, Quantity, and Diversity of goods and services
4. Improved Productivity permitting higher real incomes
5. Shrinkage of Underground Economy
6. Increases in Tax Revenues

VI. The Cooperative Sector

- December 2012 permitted Cooperatives in Non-Agricultural areas.
- Note Cuba's long history with cooperatives;

Before 1958: Various Cooperatives: Cooperativa de Omnibus Aliados:

operated 1,669 buses in 1948, or 54% of all buses in Cuba

(IBRD report on Cuba, 1950)



**“Sociedad de
Beneficencia de
Naturales de
Galicia”**

Desde 1879, su
centro regional,

**“Centro Gallego de
la Habana”,**





**Centro Asturiano, “Benevolent Society”,
founded: 1886**



GESTIONADO POR COOPERATIVA NO AGROPECUARIA







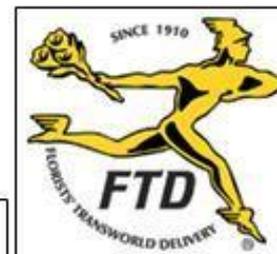
COMECU

Cooperativa de
Médicos de
Cuba

Prefeitura de Tava

PSF

Some American Coops



Advantages of Cooperatives:

■ Incentives :

- ✓ Worker ownership and management provides powerful motivation to work hard
- ✓ Profit-sharing ensures alignment of worker and owner interests

■ A more egalitarian distribution of income than privately-owned enterprises.

■ Greater degree of flexibility than state and even private firms;

- ✓ Income/profits payments to members can reflect market conditions

■ **Democracy in the work-place or among owner-entrepreneurs:**

- ✓ Valuable in itself;
- ✓ A major advantage over both state- and privately-owned enterprise;

[Workers' ownership and control is ironic since Cuba's political system is characterized by a one-party monopoly;]

- ✓ May help propel political democratization.

■ **“Second degree cooperatives” or “cooperative coalition of cooperatives”**

- ✓ Potential for reaping organizational economies of scale (a la Starbucks, Subway, McDonalds, etc.)
- ✓ Major potential for maintaining income equity;
- ✓ May maintain ownership and diffused control and profit-sharing among local citizens

Cooperative Move in Cuba:

Mixed economy with intensified “Co-operativization”

Policy Requirements

- Permit cooperatives in all areas, including professional activities;**
- Open up the current approval processes;**
- Encourage grass-roots bottom-up ventures;**
- Provide import & export rights;**
- Improve credit and wholesaling systems for coops.**

Difficulties:

1. Cooperatives generally have passed the survival test, but have not made huge inroads against private enterprise;

- **Question: are they really more efficient?**

2. Governance and Management may be a problem:

- The “transactions costs” of participatory management may be significant.
- Personal animosities, ideological or political differences, participatory failures, and/or managerial mistakes
- For larger coops, complex governance structures may impair flexibility

3. Cuba’s Actual Complex Approval process is problematic at the time: Possibility of political controls and biases

4. Certification of professional cooperatives is unclear

5. What will be the role of the Communist Party?

- ✓ Will the Party keep out of cooperative management?
- ✓ Party control would subvert workers' democracy and deform incentives structures.
- ✓ But in more distant future, the Party will not be there – I hope and expect.

Conclude:

- While a “co-operative model” for Cuba’s economy is attractive, it is no panacea, and could be “captured” completely by the state from the beginning – which appears to be what has happened.
- Could Cuba’s cooperative model be modified and made genuinely democratic? Perhaps, but that may require previous political change which also may be unlikely in the near future.

VII. Summary and Conclusion

- 1. Past policies have wasted Cuba's most important resource: entrepreneurship,**
- 2. Liberalization in 1994 and 2006-2016 generated positive results with major net benefits**
 - Current (2018-2019) back-sliding will have negative effects**
- 3. Movement towards cooperative could be useful, but its future role is ambiguous**
- 4. Further liberalization is desirable, but with caution regarding income distribution and foreign ownership and control.**

Thank You Very Much!

