

## Chapter III Economic Reform - Current State and Issues

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# Chapter III

## Economic Reform

### — Current State and Issues

#### 1. Introduction

Following the historical overview presented in the previous chapter, conditions from the beginning of the 1990s to the present are considered in this chapter. First, the occurrence of a serious crisis caused by the combination of existing structural problems and external crises will be confirmed, and then, the economic reforms implemented both prior to and following this crisis, as well as the effects and relevant issues of these reforms, will be outlined. A summary and conclusion are also presented at the end of this chapter.

#### 2. From Composite Crisis to Partial Recovery

The structural crisis in the second half of the 1980s just analyzed in Chapter 2 was combined from 1989 with a series of external shocks, including the revolution in Eastern Europe, the collapse of the Soviet Union and the dismantling of CMEA, and led the Cuban economy to experience its most serious post-revolution decline and imbalance until 1993 (Figures 2-1 and 2-3, Table 3-1). Figure 3-1 illustrates the composite crisis circuit in diagrammatic form.

First, these external shocks caused sudden declines in both exports and imports, and financing

the trade deficit became problematic. The circuit “exports → imports of production goods → investment → productivity” in Figure 2-4 was accordingly dealt a serious blow. As Cuba had depended on imports from former CMEA countries for capital goods, raw materials, fuel including crude oil, repair parts, and even a portion of its dietary staples as already mentioned, GDP, productivity, investment and consumption all automatically plunged. The original inefficient utilization of energy (Cuba used more than twice the energy per capita of Japan and France and more than 1.5 times that of the United States at the end of the 1980s)<sup>1</sup> also contributed to the aggravation of this crisis. As a result of declining domestic supply capacity, combined with a deflated former CMEA market, exports plunged with a further decline in imports, thus causing a vicious circle. Although trade deficits continued, neither the will nor the capacity to offer significant financing was evident from ex-socialist countries which had undergone economic system conversion. Relations with Western countries still could not provide a buffer to this problem. Economic sanctions by the United States were rather strengthened (this will be discussed in more detail later), and negotiations on external debt with commercial banks and the Paris Club had reached an impasse with the 1986 moratorium. Bound between upheaval and inertia in

**Table 3-1 Main Economic Statistics in 1990s**

Year	GDP	GDP Per Capita	Fiscal Expenditure	Fiscal Revenue	Fiscal Deficit	Liquidity	Exports	Imports	Trade Balance	External Debt
1990	-2.9	-4.0	15481.6	13523.5	-1958.1	4986.3	5414.9	7416.5	-2001.6	
1991	-10.7	-11.6	14713.8	10949.0	-3764.8	6662.9	2979.5	4233.8	-1254.3	
1992	-11.6	-12.3	15048.3	10179.3	-4869.0	8361.1	1779.4	2314.9	-535.5	8784.7
1993	-14.9	-15.4	14566.5	9515.9	-5050.6	11043.3	1136.5	2036.8	-900.3	9082.8
1994	0.7	0.3	14178.3	12756.9	-1421.4	9939.7	1314.2	1956.1	-641.9	9161.8
1995	2.5	1.5	12682.5	11682.5	-1000.0	9221.4	1478.5	2772.0	-561.8	10500.0
1996	7.8				-718.7	9250~9300	1966.4	3695.1	-1728.7	

Note: GDP and GDP per capita figures represent comparisons with previous years (%). Other figures are defined by million peso units (official exchange rate: 1 peso=1 dollar).

Sources: Oficina Nacional de Estadística 1995; Banco Nacional de Cuba 1995; CEPAL 1996; *Cuba News*, Vol. 4, No. 12 (December 1996); *Granma Internet*, Año 2, No. 2 (14 de enero de 1997).

Figures for fiscal deficits, exports, imports and trade deficits for 1996 were calculated by the author from the above sources.

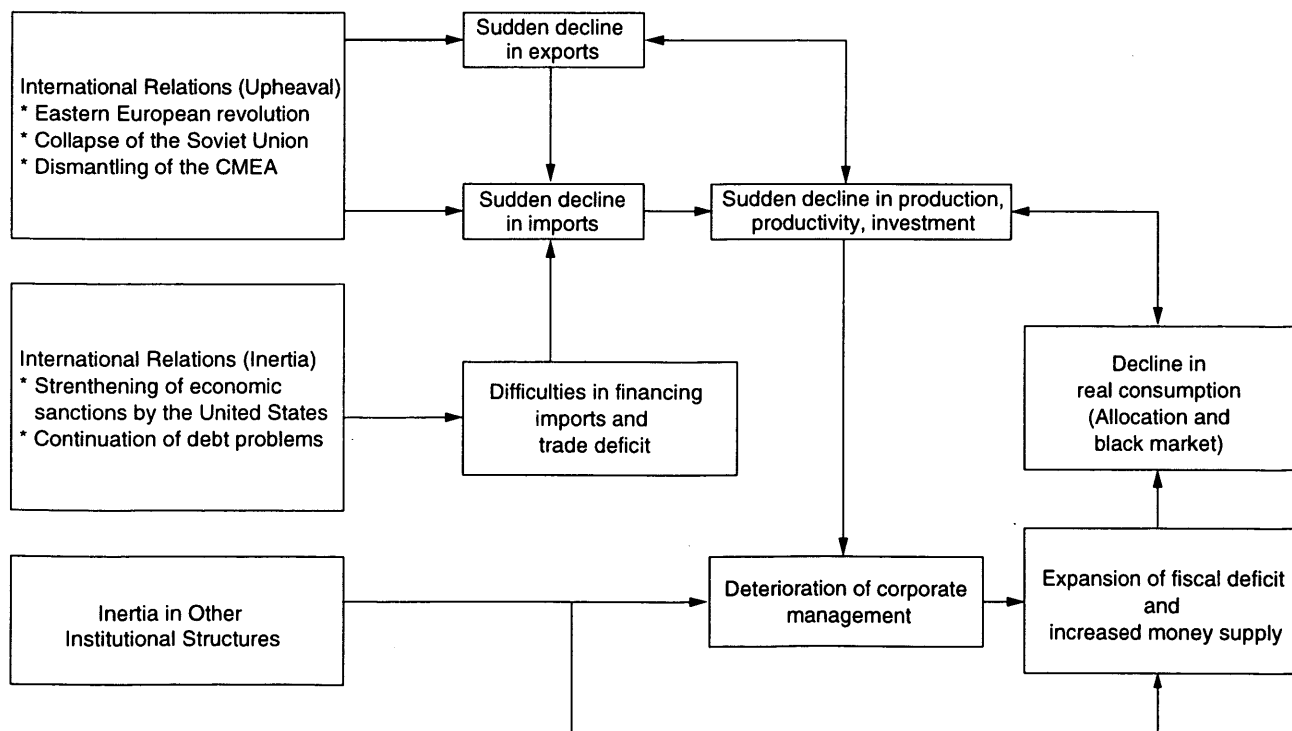
international relations, the external restriction of the Cuban economy was suddenly intensified.

Domestically, the structural crisis which emerged in the 1980s, although changing in form, essentially retained its deep-rooted inertia. First, labor-relation variables were not balanced. According to certain data, the average annual rates of change of labor productivity and GDP from 1989 to 1993 stood at -12.0% and -12.4%, respectively, while those of average wages and employment were only -0.9% and -0.4%<sup>2</sup>. This suggests a lack of adjustment in the latter figures, as well as the underlying loosened labor relations. Second, this imbalance further deteriorated corporate profitability. In May 1994, 69% of all companies were operating with a deficit<sup>3</sup>. It should, of course, be assumed that existing inefficient corporate organization also contributed to this deterioration. The third aspect was soft budget restrictions. The combination of the provision of fiscal subsidies to deficit companies and declining profit and distribution taxes (which had also been a main source of revenue under the conventional tax system) caused

by the prevalent conditions, rapidly expanded the fiscal deficit<sup>4</sup>. These subsidies were financed through money supply increases by the National Bank of Cuba, and the average annual liquidity growth rate had even risen to 30.3% from 1989 to 1993<sup>5</sup>. Fourth, the black market was inundated by unusable currency<sup>6</sup> due to equal allocation to each household of a small volume of consumer goods, for which supply had dramatically dropped, causing informal inflation. As a result, the incentive to work for a wage income naturally declined (this also being in combination with little existing material incentive and the egalitarian wage structure). As labor discipline was further loosened and gradual increases were seen in the outflow of human resources into the informal sector and the number of refugees, an additional problem of declining labor productivity was created. The composite crisis circuit illustrated in Figure 3-1 is thus completed.

Conditions existing between 1989 and 1993 have been outlined, and notable aspects which emerged after 1994 will next be discussed. According to estimates by Cuban authorities, the Cuban

**Figure 3-1 Structure of Composite Crisis: 1990-1993**



Source: Compiled by author

economy experienced continuous growth in both 1995 and 1996 at 2.5% and 7.8%, respectively, after overcoming negative growth in 1994 (0.7%) (Table 3-1; refer also to the CEPAL estimates presented in Figures 2-1 and 2-3). Growth of 4%-5% is also expected in 1997<sup>7</sup>. The relationship between labor productivity and average wages also appears to have been reversed during this period. The 1994 growth rate for labor productivity stood at 5.2%, exceeding the 2.9% growth rate of average wages<sup>8</sup>, and 1996 saw the same tendency with an 8.5% labor productivity growth rate and 6.8% average wage growth rate<sup>9</sup>. Fiscal and financial imbalance is also easing (Table 3-1). As will be illustrated next, the series of economic reforms implemented in response to the composite crisis has been the sole driving force behind these changes. Implemented interdependently, these reforms are beginning to shift conventional institutional structures in the direction of an open, mixed economy with a predominant state-operated sector (Table 2-1), and although limits and problems with reform, which will be described later, are being faced, these reforms have functioned to promote growth.

### 3. *Economic Reforms and Their Results*

The following section presents the main economic reforms implemented in Cuba and the results achieved; limits and problems will be discussed later.

#### **(1) Participation in the International Economy**

Cuba reconstructed the form taken for its participation in the international economy, and it should be noted that the state monopoly on foreign trade has been gradually rescinded. The sphere in which independent trade activities are permitted for such entities as state-operated enterprises, joint ventures which will be detailed later, and branches of foreign trading companies was expanded<sup>10</sup>. This expansion, combined with official recognition of dollarization, which will also be explained later, led to competition, albeit slight, with foreign products and could have acted as a catalyst in the improvement of domestic economic efficiency.

Another notable point is the large-scale shift to foreign investment promotion. The possibility of

establishing joint ventures with foreign companies was opened with the enactment of Decree 50 in February 1982. As previously mentioned, this shift was part of the limited decentralization (*SDPE*) which began in the middle of the 1970s<sup>11</sup>. As of 1988, however, only one joint venture (a joint hotel venture with a Spanish company) had been established<sup>12</sup>, illustrating the passivity of Cuba's acceptance of foreign investment up to that point. The unprecedented economic crisis experienced in the 1990s, however, reversed the stance of the Party and the state to that of active acceptance of foreign investment. This stance targets stronger import substitution and an increased possibility for export substitution through the capital, technology, management expertise and access to distribution networks held by foreign companies, thus easing external restrictions. Constitutional revision (1992), which adjusted forms of ownership other than possession by the state, also simplified the formalities of incorporation for joint ventures<sup>13</sup>. Foreign investment accordingly surged and has come to play an important role in the recovery of the Cuban economy since 1994.

First, the number of joint ventures in Cuba reached 212 by October 1995 (260 by 1996)<sup>14</sup>, with accumulated investments totaling slightly more than \$2.1 billion<sup>15</sup>. The new employment opportunities created by this process also surpassed 60,000 workers by the middle of 1995<sup>16</sup>. Companies from more than 50 countries had entered Cuba by May 1995, with Spain (22%), Canada (12%), Italy (8%), France (6%), Netherlands (4%), Mexico (6%) and other Latin American countries (14%) maintaining the largest shares of accumulated investment<sup>17</sup>. A breakdown of investment target sectors (accumulated investment as of May 1995) reveals industry to have been targeted most frequently (26%), followed by tourism (16%), mining (13%), petroleum (12%), construction (10%) and agriculture (5%)<sup>18</sup>. By the middle of 1995, 300 new investment projects, in addition to those already mentioned, were in the process of being negotiated, and 450 branch offices of foreign companies and trading companies had already been opened<sup>19</sup>.

Further, these investment activities have necessitated further restructuring in the acceptance of foreign investment, and new law regarding foreign investment was accordingly instituted in September 1995. This new law is more open to foreign invest-

ment than previous legislation, and offers more explicit investment procedures, as well as permitting advancement into Cuba by companies financed with 100% foreign capital and allowing total remittance of net profits<sup>20</sup>. Separate agreements concerning the protection of investment have been concluded with each individual investing country<sup>21</sup>, and the fact that Germany has ventured to conclude an agreement with Cuba on investment protection, despite the strengthening of the United States economic sanctions (the “Cuban Liberty and Democratic Solidarity Act” discussed later) is worth noting<sup>22</sup>. Finally, foundation of a free trade and processing zone was decided in June 1996, the specific application of which is an issue which will be dealt with in the future.

Extremely important institutional changes in Cuba's participation in the international economy also include the legalization of public ownership of dollars and public access to state-operated stores which deal in dollars (August 1993). As a result of the state monopoly on trade, public ownership of dollars had previously been prohibited, and stores handling dollars had been utilized only by foreign diplomatic groups and other foreign nationals. In reality, however, dollars had been distributed among a segment of the population by a number of means, including by overseas Cubans bringing dollars into the country, as well as their remittances, and tips from residents employed at foreign companies in Cuba and tourists<sup>23</sup>. Dollars were also used to purchase shortage goods on the black market, establishing a black market for foreign exchange. Under these realities, measures to legalize the virtual dollarization intended to simplify access to consumer goods for a segment of the population, and at the same time, to provide rapid growth in foreign currency revenue for the state.

This institutional reform, deliberately accepting social anomalies which will be discussed later, also brought about certain economic results. The shortage of consumer goods was alleviated to a certain extent for that segment of the population which owned dollars, estimated state collections of dollars increased to more than \$200 million in the first half of 1994<sup>24</sup>, contributing to the easing of external restrictions. With the dismantling of the state monopoly on foreign trade, official recognition of dollarization also increased competition with imported products, albeit only slightly. Stores dealing in dollars carried both domestic and foreign

products, and domestic products faced competition from similar foreign products. Although as yet indirect, this competition appears to be acting as a catalyst for increasing domestic economic efficiency.

In order to bring wholesale prices closer to international price standards, price reform was also implemented during this period<sup>25</sup>. This reform, combined with the dismantling of the state monopoly on foreign trade and the recognition of dollarization, further advanced domestic economic discipline.

## **(2) Relationship Between State and Economy and Financial System**

Important changes in the relationship between the state and the economy and the financial system include (1) approval and expansion of diverse forms of ownership and association, (2) expanded functions of the market economy, (3) an attempt to decentralize the ultra-centralized financial system, and (4) policy and institutional reform targeting hard budget restrictions. The first two changes, as well of course as the dismantling of the state monopoly on foreign trade and the third change listed here, suggest economic decentralization.

The fore-mentioned constitutional revision aside, examples of the approval and expansion of diverse forms of ownership and association include the increased number of joint-stock companies. Joint-stock companies had in the past served as an exception for trading overseas, but in the 1990s, such companies were increased in number in order to expedite the establishment of joint ventures with foreign companies and overseas transactions of state-operated enterprises. By the end of 1994, joint-stock companies numbered approximately 200, with 140 of these being state-capitalized<sup>26</sup>. It should be noted next that a conversion of state-owned farmland to cooperatives (abbreviated UBPC<sup>27</sup>) occurred and a contract production system was introduced (September 1993). Certain data quotes the number of these cooperatives (general farming and forestry) by the end of March 1995 as 1,479, with 80% of farmland, and approximately 70% of those employed in the farming sector being under the UBPC umbrella by the end of 1994<sup>28</sup>. Although farmland remains state-owned, individuals and

households belonging to UBPC enjoy usufruct rights and retain ownership of the product. Although, as will be discussed next, a large number of restrictions remain in relation to its management, this conversion to UBPC appears to at least represent epoch-making organizational change. Finally, expanded approval for self-employment (September 1993) is also relevant to the first change listed above. The number of self-employed workers reached 208,000 people in 1995<sup>29</sup>.

In addition to the establishment of a free market for agricultural products (October 1994) and a free market for certain industrial products and handicrafts (December 1994), examples of expanded market economy functions include the market territory for those who are self-employed. UBPC and a small number of agricultural economic agents such as individual farmers, and industrial product and handicraft producers are now able to sell those of their products which exceed the production volume contracted with the state on the free market<sup>30</sup>, and prices for goods and services offered by the self-employed are now determined by free demand and supply. It should be noted in this context that farm production increased in 1995 and 1996 following the establishment of the free market (4.2% and 17.3%, respectively<sup>31</sup>), and product prices in this market declined (-30% in 1996<sup>32</sup>). Although other factors such as the increased production of agricultural input goods also appear to favor this trend, these developments seem to verify the latent vigor of the Cuban market economy.

The foregoing details indicate developments in real-side economic decentralization, but an attempt to decentralize the ultra-centralized financial system has also been made. This attempt is characterized by divesting the National Bank of Cuba, which had a complete monopoly, of ordinary commercial and other banking functions, and simultaneously implementing reform designed to entrust only independent central bank functions to the National Bank. This aspect of the division and decentralization process was partially commenced in 1984 with the establishment of a general public savings bank (BPA) and international finance bank (BFI), and with the approval of establishing foreign bank branches. In 1984, however, the National Bank of Cuba still remained an "accounting center" serving the centrally planned economic system; in the second half of the 1980s, it functioned in *ex-post* ratification of distorted existing institutions and

loosened labor relations (financing the fiscal deficit by increasing money supply, as well as soft budget restrictions). By contrast, financial reform has been gradually expanded to a full scale from 1994. While constricting the previous authority and functions of the National Bank, beginning with the establishment of such new financial agencies as an international trade bank (BICSA), foreign exchange shop (CADECA) and FINSA, preparations are also being made to reorganize the bank into an autonomous central bank that can monitor the general financial system<sup>33</sup>. The legal prohibition of subsidizing fiscal deficit through money supply increases is also being reviewed. The conversion to hard budget restrictions discussed next is pioneering this institutional reform that is likely to be implemented in the near future.

Finally, a series of policy changes and institutional reforms implemented from June 1994, which have been designed to decrease the fiscal deficit, illustrate the conversion to hard budget restrictions. In terms of revenue, these reforms include raising prices on mainly non-essential goods, abolishing certain free services and reforming the taxation system (October 1994); in terms of expenditure, subsidies to deficit companies are being decreased and administrative organization rationalized. The main taxation reform includes the introduction of a uniform profit tax applied to both domestic and foreign companies, the introduction of individual income tax (mainly targeting the self-employed) and social security payment reserves made by workers themselves<sup>34</sup>, intending a sustainable taxation system which corresponds with the structural changes implemented under an unprecedented crisis. These measures have decreased the fiscal deficit and absorbed liquidity (Table 3-1). As a result, the actual peso-dollar exchange rate has declined, and the purchasing power of peso-based wages, and accordingly the incentive to work, has been restored<sup>35</sup>. These effects, in combination with other elements, have succeeded in raising labor productivity.

### (3) Corporate and Labor Reform

The third point lies in corporate and labor reform. Corporate organizational reform related to forms of ownership has already been discussed. Corporate downsizing which has been imple-

mented in coordination with this reform should be considered here. This reform also has served as the process for corporate division and decentralization. Although examples of reform success include Van Troi, a state-operated shoe manufacturer, and a number of military-owned companies<sup>36</sup>, the most striking example is the downsizing of farm scale which accompanied the establishment of UBPC as already discussed. As of February 1994, the average area managed by newly established UBPC farms was restricted to 1,190 hectares for sugar cane, 5,132 hectares for rice, 241 hectares for tobacco, 1,595 hectares for cattle raising and 456 hectares for other crops<sup>37</sup>. The impressiveness of these changes is evident in comparison with the 1990 farm scale previously mentioned. This movement itself should have contributed to further flexibility and improved efficiency in corporate and farm management. In combination with the establishment of various free markets, this reform also appears to a certain degree to have promoted market competition between the increased number of companies and management agencies caused by the division.

The following changes should also be noted with regard to labor reform. First, the adoption of independent wage scales (Table 3-2), which differ from the national basic wage scale, is remarkable in a number of strategic industries (industries which directly handle foreign currency, including tourism, sugar and mining, etc.). Although the separate wage scales adopt the fundamental job divisions set forth in the basic wage scale (Table 2-1) and maintain its egalitarian wage structure, these scales offer an overall increase in the general wage level for each of these divisions. Needless to say, these scales aim for increased incentive to work, strengthened productivity and promotion of strategic industries. In addition to the wage scales, various special material incentive systems have also been introduced in strategic sectors. Examples include the payment of wages in certificates of foreign currency with equivalent value, recognition of tip income, priority access to daily necessities and improved labor conditions, with work attendance and quota fulfillment setting the standards for this system<sup>38</sup>. While 1.3 million workers benefited from this system in 1996, those who received direct material benefits numbered approximately 830,000, a figure which corresponds to 23% of the entire work force in the state-operated and cooperative sectors<sup>39</sup>.

**Table 3-2 Wage Scale for Workers in Strategic Sector Companies (Hourly Wage)**

Major Job Divisions	Company A	Company B	Company C	Company D
	I	0.70	0.89	
II	0.89	1.05	1.15	0.90
III	1.05	1.21	1.26	1.00
IV	1.15	1.36	1.36	1.08
V	1.31	1.55	1.47	1.15
VI	1.47	1.73	1.57	1.28
VII	1.63	1.86	1.68	1.38
VIII	1.73	2.02	1.81	1.48
IX	1.89	2.20	1.94	1.61
X			2.10	1.70
XI			2.23	

Note: Wage scales approved in 1996.

Company names remain anonymous.

Source: Ministerio de Trabajo y de Seguridad Social

The changes just discussed maintain the basic framework of existing labor relations in Cuba and also reinforce these relations (as far as strategic sectors are concerned). There has been, however, also an attempt at greater nuance in reform which incorporates new elements. Labor reforms being implemented within companies under the military umbrella (so-called MINFAR) illustrate this. Since its commencement in 1987, MINFAR reform has expanded under the composite crisis in the 1990s and continues to be implemented to date. Although essential details from recent years are unfortunately unavailable, a grasp of the basic direction of these reforms is possible through a review of the original conditions<sup>40</sup>.

MINFAR companies, which became aware of the harmful effects on productivity of excessive job divisions, abolished the wage and work classification scales which had to that point been utilized, and reorganized these into 15 broad job group divisions, eliminating 358 jobs. In order to maintain continuity in production, it became necessary in some cases for workers to perform duties outside their proper work classifications. This may represent a move toward so-called "multiskilling". The important role formerly played by age in promotion to a higher ranking work classification was revised, and promotions are now determined by a worker's true ability to achieve results by the utili-

zation of qualified personnel in appropriate positions. In other words, flexibility in labor and production organization has been pursued. Without details on current conditions, it is impossible to compare this reform with Japanese flexible production methods; but new aspects to Cuban reform, which apparently recognized the global production trend (a shift to Japanese-style employment relations) that occurred at that time, were evident.

At the same time, however, the framework of conventional systems experienced renewed support with the thorough implementation of the quota system. The possibility that a social consensus on the standard intensity of labor had not necessarily been reached in post-revolution Cuba was previously touched on. In response to this, and in order to prevent a conflict of interests between management and unions, the establishment of an "objective" production quota, which is measured only by technicians and by stopwatch, has been pursued in MINFAR experiments. Once set, the fulfillment of these production quotas is strictly supervised by plant work group leaders, and wages are paid by the same piecework wage and material incentive systems which had previously been applied. In other words, an attempt is being made to tighten the loosened labor relations. Wages are no longer paid in the case of production suspension, and the fact that suspended production must be compensated for in break time represents one aspect of this shift.

These two aspects of MINFAR labor reform have achieved certain results. First, production and productivity in 1987 increased approximately 25% and 29%, respectively, over 1986 figures, and the product defect ratio stood at less than 5%. Average wages rose 2.4% with the elimination of inappropriate wage payments, wage costs accordingly fell 14 centavos, and corporate profitability improved. Total profit taxes paid to the government increased by more than 2.5 million pesos, labor discipline was strengthened, and the ratio for absence from work declined in nearly all plants and workshops.

In this respect, productivity also improved in all MINFAR companies in 1995, with profits of 77.9 million pesos registered during this year. Not only has independent management become possible, but MINFAR has been also able to finance one-fifth of military budget expenditures which had begun to be cut due to the fiscal crisis<sup>41</sup>. Serious employ-

ment problems underlying labor reform, however, emerged and will be discussed later.

#### 4. Problems

The above-mentioned economic reforms have been leveling more or less the post-revolution institutional structures. The reforms are also reorganizing the Cuban economy toward an open, mixed economy with a predominant state-operated sector as exists in China and Vietnam. On the other hand, it may be a characteristic unique to Cuba that adherence to elements of socialism, including a broad welfare system and human development, has endured since the composite crisis emerged, although with a number of setbacks. Although a comparison between 1990 and 1993 reveals declining expenditures in education, housing and regional services, expenditures in health, sanitation and social security increased, and expenditures in social assistance remained nearly the same. A comparison between 1993 and 1995 also reveals that the only expenditures which decreased were those for education, with all other expenditure categories increasing<sup>42</sup>, and this trend has continued into 1996<sup>43</sup>. Under these particularly Cuban survival strategies, the country has, at least to date, avoided a Soviet- and Eastern European-style collapse of socialist system.

As the Eastern European revolution and the collapse of the Soviet Union were events unforeseen even by scholars, the possibility of similar hidden social and political pressure in Cuba cannot be dismissed, however. In addition, although a certain amount of economic recovery has been evident since 1994, the 1996 GNP still did not exceed 72.6% of its 1989 level<sup>44</sup>. Present economic reform is still limited in this sense, and essential points in this regard are presented next.

#### (1) Expanded External Debt, Strengthened Economic Sanctions and Harmful Effects of Recognition of Dollarization

These issues are concerned with international relations and the form of participation in the international economy. The expansion of tourism and hotel facilities, mainly accomplished through foreign investment, has brought surging numbers of



tourists from Western European countries, Canada and Latin American countries to Cuba (foreign visitors to the country exceeded 1 million in 1996<sup>45</sup>), and the tourism industry has rapidly become the main source of foreign currency for the country. Despite partial export recovery (from 1994) through export substitution, however, external restrictions inherent in the country's conventional pattern of economic development have not been eliminated. In fact, the trade deficit surged again between 1995 and 1996 (Table 3-1)<sup>46</sup>.

With former Soviet-bloc countries now lacking economic power and with the dismantling of the CMEA structure, the only sources to cover this deficit currently available are the financial institutions and governments of capitalist countries. As official negotiations on external debt with Japan, the country's leading creditor nation<sup>47</sup>, have remained suspended since the 1986 moratorium, however, high-interest (14%-16%, and in some cases, 20%-22%<sup>48</sup>) short-term financial markets are the sole remaining refuge for Cuba. Since 1994, the economic recovery, as well as the increased imports which supported this recovery, have ultimately been financed by unsound external debt. The authorities' estimate of 4%-5% for the 1997 economic growth rate, which is lower than the 1996 rate, is apparently rooted in their concern over the country's immense hard currency-based external debt<sup>49</sup>. Due to severe external restrictions, imports which focus mainly on production goods and the corresponding economic growth rate must be restrained.

The strengthening of economic sanctions by the United States has expanded external restrictions, creating an entirely different international environment for Cuba than either China or Vietnam is experiencing. These sanctions are represented by the "Cuban Democracy Act" (1992) and "Cuban Liberty and Democratic Solidarity Act" (enacted in March 1996)<sup>50</sup>. The latter is particularly designed to prevent investments in Cuba by third countries and poses a critical problem for Cuba whose economic lifeline may be severed. With opposition from the European Union, Canada and Latin American countries, the application of this legislation against Cuba outside the United States has been delayed. The threat of these conditions, however, has somewhat weakened foreign investment, which is illustrated by the rumored withdrawal of CEMEX, a Mexican cement company, from Cuba<sup>51</sup>. By increasing the risk involved in dealing with Cuba, this legislation is

also indirectly contributing to the expansion of external debt (high interest rates).

The final issue related to the form of participation in the international economy, social problems related to official recognition of dollarization, is also important. As is well-known, this measure has meant acknowledgment of the serious income difference between strata with access to dollars and those without. In a sense, the egalitarian wage structure and system of welfare targeting the entire population represented the justice of the revolution. If foreign currency income, which is not necessarily based on labor, directs the population's livelihood, this justification will be destabilized. It is certain that the purchasing power of the peso has been restored through absorption of liquidity, but reports by authorities which declare improved income distribution appear in fact to lead to a completely opposite situation<sup>52</sup>. In whichever case, it is evident that recognition of dollarization has negatively influenced the incentive to work and productivity.

## **(2) Balance of Power and Relationship Between the State and the Economy**

The second issue lies in the balance of power which has affected the speed and direction of economic reform. Impelled by the unprecedented crisis, the economic reform implemented to date has been largely ad hoc in nature and not necessarily grounded in a consistent reform strategy<sup>53</sup>. A relatively passive reform path advocated by the political elite (those who, although essentially supportive of conventional institutional structures, are permitting partial reform as a pragmatic tactic for surviving this crisis) has dominated. The reason for this lies in the lack of power of those advocating active reform, despite the existing, but unorganized willingness of the public for social change, as has been evident by massive emigration, dissatisfaction of the urban residents expressed in outcome of the 1993 election<sup>54</sup> and the August 1994 demonstrations. Thorough reform will remain problematic as long as this balance of power continues. The relationship between the state and the economy (particularly its domestic aspect) is in fact currently directed by the deep-seated inertia of the centrally planned system, as seen for example in the problems surrounding UBPC which will be detailed

next, and this inertia is repressing elements of the newly instituted decentralization policy.

### (3) Sustainability of Corporate and Labor Reform

The third issue concerns corporate and labor reform. The corporate reform implemented to date has generally been limited to internal reform, particularly to downsizing, with almost no progress made on such re-evaluation of inter-corporate relations and industrial organization as the revision of excessive vertical integration. Although no means of determining the extent of progress in labor reform in companies other than MINFAR are available, it can be assumed that, even with the implementation of reforms, the majority are likely to have been only partial adjustments which reinforce conventional labor relations. Although it was previously stated that subsidies for corporate deficits have decreased since 1994, 2.15 billion pesos had been appropriated for this purpose in the 1995 budget<sup>55</sup>. Adding the values of UBPC subsidies described later to this figure, overall, these subsidies are only slightly lower than they were in 1989, which suggests both the success and limitations of reform.

The fragility of management in the newly established UBPC organization is also related to this issue. This farming management organization, founded with both purposes of decentralization of management and downsizing, has in reality been limited by various centralized regulations (product composition, market and sales price, location and price in purchasing inputs, etc.), and is still far from an optimal size<sup>56</sup>. With access to an agricultural free market, including products for private consumption, being prohibited by law, the sugar cane UBPC particularly lacks opportunities for high revenue. This, in combination with the original severe work and living conditions in rural villages, is causing an outflow of workers from UBPC. Overall, UBPC received 67.8 million pesos in fiscal subsidies in 1994 and 400 million pesos was appropriated from the 1995 budget<sup>57</sup>. In addition, 61% of UBPC were facing deficit operations in 1995<sup>58</sup>.

An additional issue related to corporate and labor reform is the "collapse" of full employment. Massive layoffs accompanying the downsizing and the division of companies have been implemented, and the unemployment rate reached 7% in 1995<sup>59</sup>.

MINFAR-type flexibility in labor and production organization has also encouraged this tendency. MINFAR had already dismissed 284 people in 1987<sup>60</sup>, and again reduced personnel by 20% to 30% in 1995<sup>61</sup>. These massive dismissals could not certainly be realized without an *ex-ante* plan in Cuba, a socialist nation. A safety net incorporating mediation in reorganization and reassignment, as well as partial guarantee of wages (continuous wage payments of 100% for temporary reassignment, 80% for final reassignment, and one month's wages plus 60% of wages over a specified time period which corresponds with the period of employment for unemployment), has been established<sup>62</sup>. However, although conditional employment and wages are guaranteed, this represents a fairly essential institutional change from the country's former principle of *ex-ante* full employment. With acceptance of the social differences accompanying the recognition of dollarization, this reform contradicts the basic idea of the revolution. The expanded approval of self-employment already mentioned was also designed to absorb the pressure created by unemployment.

## 5. Conclusion

A summary of this chapter will serve as its conclusion.

The fusion of the structural crisis in the second half of the 1980s and the external shocks around 1990 represented by the collapse of the Soviet Union resulted in an unprecedented composite crisis in the Cuban economy from 1990 on. Between 1990 and 1993, both GDP and per capita GDP dropped dramatically, and the gap between productivity and wages, corporate deficit and inflationary subsidies for these deficits further intensified the existing economic imbalance. This brought about a series of fundamentally Chinese and Vietnamese-style economic reforms. These reforms included opening the country to external forces such as the introduction of foreign capital and recognition of dollarization, reevaluation of the relationship between the state and the economy one symbol of which is a reopening of the agricultural free market, corporate and labor reform involving downsizing, conversion to cooperatives at state-operated farms, expanded approval of self-employment and flexibility in employment relations, as well as financial and fiscal reform which

emphasized discipline and balance. Through these reforms, which targeted an open, mixed economy with a predominant state-owned sector, Cuba was able to avoid a Soviet- and Eastern European-style collapse of its socialist system. Economic results began to improve in 1994.

Full recovery, however, is still distant, with both domestic and foreign problems to be faced. First, compared with China and Vietnam, the country faces external obstacles, including the strengthening of economic sanctions by the United States and problematic negotiations on external debt. In order to overcome this type of restricted international relations and promote further economic development, a historical conversion from Cuba's conventional import-substitution industrialization to efficient export-substitution development, as well as further pursuit of substantial reforms necessary for it, is essential. But those advocating active reform do not have sufficient power within the Party, resulting in relatively cautious and slow reform (particularly in domestic front). In this regard, contradictions arising between the social consequences from certain reforms (including the expanded income gap due to the recognition of dollarization, and massive dismissals due to corporate and labor reform, etc.) and previous revolutionary ideology have been influential as well.

The only certain prospect which can be offered in conclusion is that, despite these limitations, the pursuit of economic reform in Cuba is essential as post-revolution institutional structures and the economic development pattern formed under these structures had reached their limits prior to the Eastern European revolution and the collapse of the Soviet Union. There can be no turning back at this point. It is vital that appeals of economists advocating more consistent implementation of systematic reforms, and domestic reform in particular, and suspension of the inertia of the past be followed. The social and political sustainability of this process, however, is something which no one can guarantee.

#### Notes:

- 1 Figueras 1994, p. 114
- 2 Ferriol 1996, p. 12
- 3 Carranza, Gutiérrez y Monreal 1995, p. 29
- 4 Revenue from profit and distribution taxes in 1989 stood at 1.8879 billion pesos and 5.1382 billion pesos, respectively, but had fallen to 1.3999 billion

pesos and 3.3101 billion pesos by 1993. In addition, expenditures to cover corporate deficit had risen during the same period from 2.6539 billion pesos to 5.4339 billion pesos. Banco Nacional de Cuba 1995 Appendix 4

- 5 Ferriol 1996, p. 12
- 6 In terms of total value, the scale of the black market in the middle of 1993 had expanded to more than 7 times its size in 1989. Carranza, Gutiérrez y Monreal 1995, p. 29
- 7 "Creció la economía 7.8%," in *Granma Internet*, Año 2, No. 2, 14 de Enero de 1997
- 8 Ferriol 1996, p. 17
- 9 "Creció la economía 7.8%." Only average wage data were obtained for 1995 (CEPAL 1996, p. 9), which estimated the average wage growth rate for this year at 3.8%. Although not specified, the growth rate for labor productivity in 1995 is estimated to have been less than this figure (ibid.).
- 10 Carranza, Gutiérrez y Monreal 1995, p. 34
- 11 CEPAL 1995, pp. 8-9
- 12 Ibid., p. 10-Cuadro 2, p. 12-Cuadro 3
- 13 Ibid., p. 2; Carranza, Gutiérrez y Monreal 1995, p. 35
- 14 Instituto de Investigaciones Financieras 1995, p. 17; "Creció la Economía 7.8%"
- 15 Instituto de Investigaciones Financieras 1995, p. 17
- 16 CEPAL 1995, p. 2
- 17 Ibid., p. 10-Cuadro 2
- 18 Ibid., p. 12-Cuadro 3
- 19 Ibid., p. 2
- 20 Certain conditions included in this legislation are more open than those in Chinese and Vietnamese legislation. For details on comparisons with foreign investment acceptance in these two countries, refer to Molina 1996. A table outlining a comparison of recent and former legislation regarding foreign investment is provided in CEPAL 1995, p. 19.
- 21 Countries which had concluded agreements with Cuba as of February 1996 include Italy, Spain, Colombia, United Kingdom, China, Bolivia, Ukraine, Russia, Vietnam, Argentina, South Africa, Lebanon, Chile, Romania and Barbados. Centro de Estudios Sobre América 1996b, p. 12, Anexo 10
- 22 *Latin American Weekly Report*, 16 May 1996, p. 213
- 23 Throughout nine provinces, 30%-60% of the population were in possession of dollars in the middle of 1996. "Creció la Economía 7.8%"
- 24 Centro de Estudios de la Economía Cubana 1995, p. 53, Nota 16
- 25 Carranza, Gutiérrez y Monreal 1995, p. 38
- 26 Ibid., p. 33
- 27 Unidades Básicas de Producción Cooperativa
- 28 Instituto de Investigaciones Financieras 1995, p. 25
- 29 CEPAL 1996, p. 6
- 30 Carranza, Gutiérrez and Monreal 1995, pp. 43-47;

- Instituto de Investigaciones Financieras 1995, pp. 26-30
- 31 CEPAL 1996, pp. 7 and 16; Pons 1996, p. 27; "Creció la Economía 7.8%"
- 32 Ibid.
- 33 Banco Nacional de Cuba 1995, p. 27 mentions the roles the new central bank should play in the future.
- 34 Instituto de Investigaciones Financieras 1995, pp. 37-39
- 35 Actual rates fell from 32.1 pesos to the dollar in 1995 to 19.2 pesos in 1996. The entire country should have seen exchange gains of approximately \$23 million as a result. "Creció la Economía 7.8%"
- 36 Torras y Marcelo 1995, p. 4
- 37 Ibid., p. 4
- 38 Instituto de Investigaciones Financieras 1995, pp. 56-57
- 39 "Creció la Economía 7.8%"
- 40 Although basically compiled from data of Pérez y González 1988, the following also includes the author's own interpretations of it.
- 41 *Granma* (12 de Marzo de 1996), cited in Centro de Estudios Sobre América 1996a, p. 56
- 42 For specific details, refer to CEPAL 1996, p. 26, Cuadro 12.
- 43 "Creció la Economía 7.8%"
- 44 Figures compiled from "Creció la Economía 7.8%," Oficina Nacional de Estadística 1995, and CEPAL 1995.
- 45 "Llegó el Millión de Visitantes," in *Granma Internet*, Año 2, No. 2, 14 de Enero de 1997
- 46 Although this figure does not correspond with Table 3-1 values, the trade deficit reached \$2.2 billion (15.5% of GNP) in 1996 according to Lage, Vice-President, National Council (*Cuba News*, Vol. 5, No. 1, January 1997, p. 7).
- 47 In terms of hard currency-based debt only, the leading creditor nation to Cuba is Japan (25%) at the end of 1994, followed by Spain (13%), France (12%), Argentina (9%) and the United Kingdom (8%) (Banco Nacional de Cuba 1995, p. 25, Chart 12).
- 48 *Cuba News*, Vol. 5, No. 1, January 1997, p. 11; *Cuba News*, Vol. 4, No. 12, December 1996, p. 2
- 49 *Cuba News*, Vol. 5, No. 1, January 1997, p. 11; *Cuba News*, Vol. 4, No. 12, December 1996, p. 2
- 50 Refer to Yamaoka 1993 for details on the former and to Yamaoka 1996 for details on the latter.
- 51 *Cuba News*, Vol. 4, No. 6, June 1996, p. 6
- 52 According to a National Assembly report at the end of 1996 by Economic and Planning Minister, Rodríguez, although a comparison between 1989 and 1996 per capita income by income class revealed no great change among those receiving an income of up to 50 pesos, incomes among those in the 51-151 peso range decreased, while incomes among those in the 151 peso and higher range increased. Rodríguez dubbed this "positive evolution," ("una evolución positiva") but it is difficult to understand how this evolution can be considered positive. Refer to "Creció la Economía 7.8%."
- 53 Carranza 1995, p. 18
- 54 Koike 1996, p. 19
- 55 Banco Nacional de Cuba 1995, Appendix 4
- 56 Nova 1995, p. 71; González 1995, pp. 90-92
- 57 Banco Nacional de Cuba 1995, Appendix 4
- 58 Bu, Fernández, Nova, García, Alayeto y Atienza 1996, p. 33
- 59 CEPAL 1996, p. 10. Includes unemployment due to administrative reform as well.
- 60 Pérez y González 1988, p. 72
- 61 *Granma* (12 de Marzo de 1996), cited in Centro de Estudios Sobre América 1996a, p. 56
- 62 Instituto de Investigaciones Financieras 1995, pp. 54-55