

Cuba's Top Social Justice Challenge: Bridging the Earnings Gap

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Economic planning is widespread in Cuba, but the predominant feature of Cuba's labor market – the huge disparity in purchasing power between workers who have hard currency incomes and those whose salaries are paid in Cuban pesos – seems to have come about almost by accident.

The result is a deep inequality that raises profound questions of social justice. This inequality has prevailed for a decade, paradoxically, in a country committed to socialist values.

Cuba's inequality is not the product of a genuine market valuation that assigns greater worth, say, to the labor of a bellboy as opposed to that of a doctor. Rather, it is the result of a strategy of economic survival adopted in the 1990s where hard currency was permitted to circulate alongside the “legacy” currency of the planned economy, the peso, and where a series of economic reforms gave rise to two labor markets and two markets for consumer goods, each with its own currency.

Cuba's strategy did allow Cuba to survive the sudden loss of its economic relationships with the Soviet Union and Eastern Europe; modest growth has been restored and some healthy economic diversification has also resulted. But the new inequality that came along with this economic recovery is problematic from any perspective, socialist or capitalist, and it is a principal challenge facing Cuban economic policy today.

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The demise of the Soviet bloc deprived Cuba of a subsidy that by some estimates amounted to one-fourth of gross domestic product, and it cut Cuba off from the trading partners, contracts, and supply relationships that accounted for three-fourths of its foreign trade. The division of labor between the members of the socialist economic bloc, the subject of negotiated five-year plans, became irrelevant. Cuba's domestic economic planning, which was in large part derived from those international relationships, became unworkable. By 1993, gross domestic product had fallen by more than one-third, factories were idled, inflation devalued the peso, agriculture went into crisis, fuel was scarce, and Cuba's economy came as close to collapse as could be imagined.

In response, the Cuban government did not abandon its commitment to socialism, but it engaged in a tactical retreat from the orthodoxy of socialist state planning.

With shortages of fuel, machinery and spare parts plaguing large-scale state farms, Cuba turned to smaller-scale, incentive-based production. Large state farms were divided into smaller cooperatives, land was distributed to new individual producers, and agricultural producers of all types – state farms, cooperatives, individual private farmers – were given a new deal: once they delivered their production quota to the state, they were free to sell their surplus at prices they themselves determined. A network of more than 300 farmers markets sprouted up in cities and towns across Cuba to bring this market-based produce to consumers.

To mitigate unemployment and underemployment – and to catch up with an entrepreneurial reality that was emerging without regard to legal norms – Cuba legalized limited, small-scale enterprise, or self-employment. By 1996, 209,000 Cubans held licenses to operate little businesses, from family restaurants and cafes (the only type where employees, called “assistants” are permitted) to carpenters, tutors, messengers, repairmen, seamstresses, taxi drivers, and artists. Cuba’s income tax, dormant more than three decades, was revived that year to claim a share of this new sector’s revenue for the state. Then as now, hundreds of thousands more operate full-time or part-time without licenses.

Cuba also made a limited opening to foreign investment – not by opening its doors wide to all comers, but by identifying projects where foreign capital and technology were desired, and then selecting partners for those projects only. By decade’s end, more than 300 joint ventures were in operation. The smallest included advertising agencies, automotive assembly operations, and light manufacturing. The largest and most consequential involved nickel and energy production, utilities, and telecommunications. And tourism, largely shunned since the early days of the revolution, was once again welcomed to an island where tourism is surely an area of strong comparative advantage. Foreign capital and know-how were essential to the re-launching of this industry, which now welcomes more than two million visitors annually, six times the level of fifteen years ago.

These reforms produced tangible and broad results. Growth was restored by 1994 and has remained positive ever since. Sugar, long the center of the Cuban economy, was bypassed by tourism, the new top foreign exchange earner. Crude oil production quadrupled in the 1990s, natural gas production increased twenty-fold, and nickel output nearly doubled. Slowly but steadily, neighborhood by neighborhood, Cuba’s museum-piece telephone network is being modernized. Farmers markets and small organic farm cooperatives emerged as a new, reliable source of food, although at market-determined prices far higher than those Cubans see when they take their ration books to state food distribution centers.

With these changes, socialist Cuba became a place less averse to experiments with market mechanisms. There was a widespread expectation that additional reforms would spur more growth by further lightening the state's hand in economic direction, decentralizing economic decisionmaking, and even allowing a level of economic competition. For example, in the mid 1990s Cuban officials and academics discussed possible legislation to permit small and medium-scale enterprise.

But this was not to be.

The "reanimation" of Cuba's economy, as officials call it, led not to more reform, but to a sense in official circles that Cuba could afford to rely less on the market-based mechanisms that, however successful, were fundamentally a departure from the prevailing governing philosophy. The great ideological flexibility that allowed communists in China and Vietnam to countenance ever-larger doses of capitalism was not to be found in the Central Committee of the Communist Party of Cuba. Fidel Castro knew precisely what Cuba was doing as it adopted the reforms of the 1990s, and it seems he was holding his nose all the way.

The reforms have not been abandoned, but since 2003 a policy retrenchment has now reduced some of their scope and impact. Hundreds of state enterprises that had autonomously managed foreign exchange accounts and made import-export decisions found themselves once again governed by ministry officials in these basic business operations, and these operations remain under centralized control today, even after Cuba has reportedly accumulated a cushion of foreign exchange reserves. Small entrepreneurs were squeezed by new regulations and tougher enforcement, and their ranks were reduced by one-third. (Unlicensed, unquantifiable entrepreneurship continues to thrive.) Cuban authorities have also quietly squeezed the foreign investment sector, and more than one hundred mainly smaller joint ventures have shut their doors.

At the same time, Cuba has pursued a strategy of international economic partnerships that has paid dividends. Since 2004, Canada's Sherritt International decided to expand nickel production with a half-billion dollar investment. Also in the nickel sector, where world prices are up seventy-five percent in the past five years, China has pledged \$1.5 billion in new investment. Venezuela provides subsidized oil, paid in part by the export of Cuban services – doctors, teachers, and sports trainers that are now an integral part of the social, and some would say electoral, program of President Hugo Chávez. A new offshore oil field has been discovered, and is estimated to contain more than two years' worth of Cuba's national consumption. Companies from Asia, Europe, and Latin America are involved in additional oil exploration, feeding the hope that the Gulf of Mexico's light, sweet crude oil might extend to Cuban waters, and might one day make Cuba an oil exporter.

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So post-Soviet Cuba has revived and restructured its economy so that, while far from prosperous, its survival is no longer at issue. But while at the "macro" level the socialist

economy and polity managed to avoid their widely predicted collapse, at the “micro” level the restructuring introduced an inequality of income and opportunity that is an affront to socialist ideals and a threat to the economy’s long-term health.

When Cuba was tied to the socialist economic bloc, it had a single currency, the peso, which was not convertible, and it was illegal for Cubans to hold foreign currency. In 1992, with the economic crisis at its worst, all penalties associated with holding foreign currency were repealed. This move encouraged émigrés to send cash remittances to relatives in Cuba. It also made Cubans the only people on earth who would virtually live in two economies at once – call them Cuba’s “old” and “new” economies – one of them largely characterized by transactions in pesos, the other by transactions in hard currency. Some have jobs that place them squarely in one economy or the other, some have a foot in each, some find a way to move from one to the other. But no Cuban is neutral on this question, because in the old economy one has to struggle to meet basic family needs, and in the new economy one does not.

Cuba’s old economy is a continuation of the socialist structures put in place at the beginning of the revolution. It is inhabited by those who work directly for the state – doctors, teachers, officials at all ranks of central and local government – and those who work for hundreds of state enterprises that are subordinate to government ministries. Salaries are paid in pesos and average about 260 pesos per month, which translates to about ten dollars in value.

The new economy is the result of economic reforms of the 1990s, and for Cuban workers its most important characteristic is that it offers opportunities for higher earnings, often in hard currency, and at times in settings that allow a degree of entrepreneurship. Workers in joint ventures receive their base pay or productivity bonuses in hard currency; workers in tourism businesses earn tips in hard currency; licensed entrepreneurs earn about three times the average state salary; and vendors in farmers markets can earn even more.

Income inequality is found in all economies, but the gap in purchasing power among Cuban workers today is particularly sharp. All Cubans receive a monthly allotment of basic foods at heavily subsidized prices, but ever since the early 1990s, this allotment has not been sufficient to meet a family’s needs for a full month. Families need to buy food at farmers markets, and they need hard currency to buy clothing, appliances, cleaning supplies, and other household items.

To appreciate the impact of disparate incomes on purchasing power, consider a 194-peso shopping trip that a Cuban homemaker would need to make to buy a pound each of pork, rice, and black beans, two pounds of tomatoes, three limes, and one head of garlic, plus a bar of soap, a kilogram of detergent, and a tube of imported toothpaste. A doctor needs to work eight days to earn enough to buy that basket of goods; a professor about two weeks, and a preschool teacher six weeks. By contrast, an average licensed entrepreneur would need to work five days to make those purchases, a meat vendor in a farmers’ market three days, a private taxi driver a day and a half, a Havana bed-and-breakfast entrepreneur six hours, and a waiter at a beach resort restaurant three hours.

This shopping trip illustrates the heart of Cuba's inequality problem: In today's labor market, Cubans of equal qualifications who work with equal dedication can find that their earnings are widely disparate. More striking, as is the case with the doctor and waiter discussed above, a Cuban with advanced education and experience may find that his earnings are dramatically lower than that of a neighbor who lacks advanced education and experience but has the good fortune to work in a restaurant where he can earn tips in hard currency from tourists.

So Cuba, a socialist country that prides itself on equality and guarantees of social welfare, has created a labor market that somewhat arbitrarily produces winners and losers.

One can argue that the winners in this equation symbolize positive policy developments: an acceptance of incentive-based agricultural production, a degree of small entrepreneurship, an opening to international tourism and a need for tourism industry workers and managers to learn new skills to compete in a global market, exposure of Cuban workers to international business practices and incentive-based pay in the joint ventures with foreign investors.

But the losers' side of this equation highlights a series of problems that go beyond social inequality.

In relative terms, Cuba's distorted labor market overvalues any skill related to tourism and undervalues higher education, thereby threatening one of the great assets of Cuban society, a well educated population. Professionals who have received years of training have incentives to advance not by using their training, but by finding a way into the tourism industry where pay is higher than in any academy, research lab, or hospital. (It is not hard to run across Cuban physicians moonlighting as taxi drivers.) At the other end of the age spectrum, many Cuban youths see no reason to pursue higher education and go on to work for the state, when they can instead try to improvise a way to earn ten dollars in a few days, thereby matching a government job's monthly wage. This phenomenon poses dangers for Cuba's long-term economic health.

So does the fact that income inequality is also driving Cubans to engage in vast amounts of black market activity. To supplement income, many Cubans pilfer goods such as construction materials from the state to sell on the black market. Others engage in entrepreneurial activity that would be applauded in most countries but is illegal in Cuba – from running an unlicensed carpentry business to selling cheese and meat door-to-door. As widespread as these activities are, they do not indicate that Cuba is a nation of thieves and cheats. Rather, they indicate that Cuban law, combined with contemporary economic necessity, has led to a culture of illegality through conduct that by most moral standards involves little or no wrongdoing.

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Cuba's inequality could almost be called structural, because it grew in direct proportion to the bifurcated economy created in the 1990s. It has two dimensions: an income gap and an opportunity gap. Depending on one's economic policy preference, one may or may not be troubled by disparate incomes within a country's labor force, but in Cuba the income gap is particularly serious because the honest labor of low-income Cubans is not enough to cover their basic needs. (It is also politically ironic, as professions such as medicine and education, deemed to be of the highest social value by the revolution, earn relatively low incomes.) The opportunity gap is quite evident when one talks to Cuban workers; many would prefer to work in tourism or other areas of the new economy, but the supply of jobs there is limited.

So how could Cuba's inequality problem be addressed?

There are a wealth of capitalist prescriptions for Cuban economic policy, many predicated on political change. Considering that political change does not seem imminent, and that the problem of inequality is troubling to socialists in particular, it is interesting to consider how socialist economic policies might attack this problem.

Two ingredients are needed. Economic growth is necessary to generate income to maintain social services and to generate new jobs – but it is not sufficient. Cuba also needs to create a bridge to reduce the distance between workers in the old and new economies. The more revenue is generated by economic growth, the easier that bridge will be to construct.

Cuba's current ideological framework, based on belief in a predominant state role in all economic matters and buttressed by recent macroeconomic improvements, is not likely to change until a new generation assumes political leadership. For the foreseeable future, then, we are likely to continue to see a Cuban government that is decidedly disinclined to engage in economic reforms that would expand market incentives and private initiative.

However, we do see attempts today to chip away at the income gaps that separate Cuban workers. As Cuba's foreign exchange reserve position improved in 2005, the central bank increased the value of the Cuban peso by seven percent against the dollar, and concurrently a ten percent surcharge was imposed on exchanges of dollars for the "peso convertible," the nonconvertible currency that Cubans must use in state hard currency establishments. In addition, the state has boosted salaries and pensions. The net impact of these changes is to favor peso earners at the expense of Cubans who hold dollars or who receive them through family remittances.

These efforts may signal moves yet to come if Cuba's financial position continues to improve. But absent a stunning oil discovery in Cuba's Gulf of Mexico waters, it is difficult to envision a genuine elimination of this income gap without significant new economic growth and change in economic policies. Government measures imposed from above – calibration of salaries, exchange rates, and government-controlled consumer prices – will one day need to be accompanied by growth that comes from below through individual and even private initiative.

Of course, merely to mention proposals involving private initiative is to push this discussion into a future where a generational shift, or at least an ideological shift, has occurred. But a post-Castro government might find that even within a socialist framework there is ample opportunity to set a new policy course that generates substantial growth. This could be done simply by returning to the reforms of the early 1990s and building on them – a move that Castro’s successors might make not only for economic betterment, but also to generate political support.

The policy change closest at hand would be to develop a sector of small businesses by expanding the self-employment system that now allows about 150,000 Cubans to work as licensed entrepreneurs. This would require a reversal of the government’s current attitude, which is leading to the state reclaiming areas of business activity such as food service that small entrepreneurs have been providing since 1993 in cities and towns across Cuba. By adopting a more permissive policy toward licensing, easing taxes and regulations, allowing entrepreneurs to work in partnership with each other, and creating a reasonably priced wholesale supply system, Cuba would see more than an increase in job creation. A larger entrepreneurial sector would generate new revenue for the government, it would reduce illegality as those operating in the shadows opt for the advantages of licensed work, and it would reduce the government’s burden of providing social services for underemployed Cubans. If extended to all professions, such an opening would produce the experimentation and innovation inherent in any small business sector, and in Cuba’s case, this would be spurred by a workforce that possesses relatively high levels of education and technical training. Cuba could also dust off studies that were done a decade ago when it seemed that a small and medium-sized business law would be written. Even if such a law were limited to state enterprises, it would have the potential under a proper policy framework to improve the state enterprise sector itself.

Agriculture is one area that has not been affected by the current policy retrenchment. The simple step of allowing cooperatives and private farmers to sell surplus production at free-market prices has increased the quantity and variety of food available to consumers. Further liberalization of this sector could increase production and incomes.

Finally, a reversal of the current policy course regarding foreign investment would pay dividends. Either due to belief in self-reliance or a desire to reduce the ideological contamination that comes with the presence of foreign businesses, Cuba has reduced the number of joint ventures operating on the island and seems to be concentrating on larger investments only. The political decision to usher scores of foreign partners out the door seems to have overridden any concern about investor confidence; surely, it will be difficult to attract new investors back if such a decision is made in the future. But if that damage can be repaired there is little doubt that a new policy attitude, combined with liberalized conditions for investing and operating in Cuba, could bring considerable benefits to Cuba’s economy.

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It is impossible to tell how much additional reform would be needed to eliminate Cuba's inequality problem, but it is clear that minor adjustments will not do the job.

The health care sector gives one indication of the size of the task. Cuba prides itself on a health care system that employs large numbers of doctors and places them close to the population in every municipality across the island. If this prized aspect of Cuba's social service sector is to be preserved, and if doctors are ever to be paid on par with taxi drivers in the tourist sector, then Cuba's new economy will need to expand greatly. Only with vastly increased government revenues will it be possible to end today's inequality by eliminating the dual currency system altogether, or by boosting the salaries of doctors and all other state workers to a degree where their purchasing power equals that of workers in the new economy.

If oil, nickel, tourism, biotechnology, and other export industries continue to perform well, the state will be able to continue narrowing Cuba's income gap through salary adjustments and subsidies.

But changes in economic policy would enable the Cuban state to do far more. A new round of market-based reforms would provide dual benefits – new revenue for the state, higher incomes for thousands of Cuban families – but the state is moving away from reform now rather than embracing it. When it comes to attacking Cuba's problem of inequality, then, the greatest obstacle seems to be its own leadership's state of mind.