



From the ASCE president

Dear Members,

I hope this newsletter finds you well. On behalf of the Board, thank you for a successful and highly informative XXI Annual Conference in Miami earlier this month. We were very pleased to see each other in person, to meet our many new attendees, and to review our research which was timelier than ever. Among the highlights of our conference was the re-dedication of our Keynote Address to the memory of Ernesto Betancourt, and its delivery by Distinguished Professor Emeritus Carmelo Mesa-Lago. As in prior years, we had excellent student presentations and we were pleased to award the Student Prize to our participants in person. We also had outstanding participation from academics and other professionals, including participants not just residing here in the US, but also from Cuba, Venezuela, Canada and other countries. We look forward in the coming year to deepening our relationships with these participants and others interested in the Cuban economy as ASCE continues its efforts to improve the quality of research shaping the public dialogue on Cuba. We invite you to browse at a few pictures taken at the conference, included at the end of this newsletter.

We expect to have the articles presented at the conference on our webpage and in printing by November of 2011. To make this possible, we need our conference participants to edit and incorporate the comments received on their work quickly and send their final versions to ASCE for publication. Hence, please note that your final submissions for publication in *Cuba in Transition: Papers and Proceedings of the XXI Annual Meeting of the Association for the Study of the Cuban Economy* are due to Jorge Pérez-López by September 15, 2011.

We also look forward in the coming year to broadening our outreach. So far, we have had considerable success in improving ASCE's presence and efficient use of the internet. We have revamped our existing web page, including by moving to a professional internet service platform, added the ability to pay via credit card, and added a database of all our published research. We have also made progress in promoting ASCE via our presence on social networking sites, including Facebook, a Facebook fan page, LinkedIn, and Twitter. In the coming year, we expect to continue to grow our presence on the internet, which depending on the

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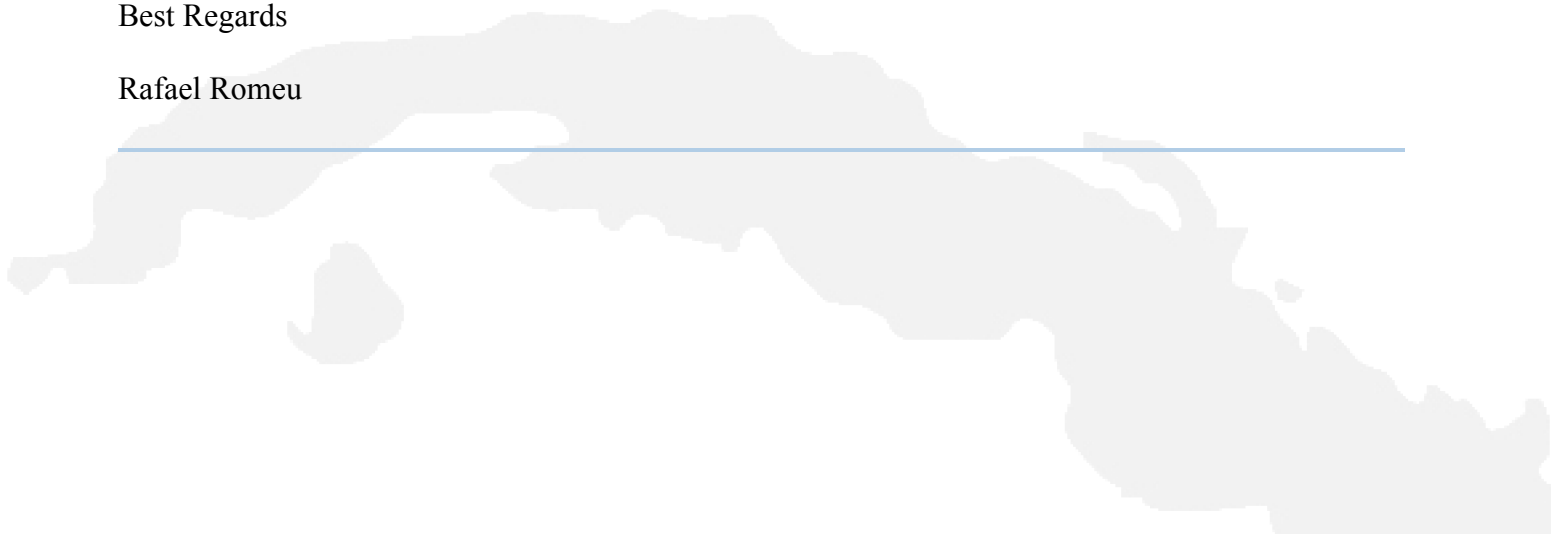
available funding, will include further improvements to our ASCE homepage, as well as exploring opportunities for ASCE's webpage to actively deliver content based on our members' research.

The considerable media coverage at the conference was, as always, welcome and supported by ASCE. Encouraging scrutiny of our work by the media and the broader public is both an incentive to deliver the highest quality work possible, and an example of the transparent and evidence-based research environment that ASCE looks to promote within Cuba and elsewhere. The Board feels that it is important that we recognize and support this core value of ASCE by (i) the membership identifying itself as ASCE members when giving presentations or media interviews, and (ii) that no one member ascribe his or her views as the official views of ASCE. ASCE's mission is to promote a greater understanding of how the Cuban economy and society works by supporting unbiased economic and social research among public policymakers, business professionals, and the academic community. ASCE provides a venue for bringing this research community together, promoting, improving and publishing their work. Consistent with this role, the Board of ASCE as such rarely takes a view on specific issues relating to Cuba, focusing instead on promoting serious and high quality research on the Cuban economy (in the broad sense, including microeconomic and sectoral studies such as architecture or infrastructure, as well as sociological, legal aspects of economic development). Hence, to help us strengthen our organization it is important for our members to both identify themselves as members of ASCE while also not associating their own views as ASCE's official views.

The Board looks forward to working hard in the coming year to fulfill our commitment to continue ASCE's mission into its twenty-second year. A large part of this commitment consists of organizing the annual conference, which this year was done thanks to the hard work of ASCE's all volunteer Board of Directors, whom I would like to thank and acknowledge for their service to our organization. I would also gratefully acknowledge the tireless efforts of two long-time pillars of ASCE, Jorge Pérez-López and Joaquín Pujol, whom work very hard to make the conference a reality. We look forward to continued success 2011-12 and hope to see our members at our events very soon.

Best Regards

Rafael Romeu





From the ASCE treasurer

Dear Friends,

We are ending the month of August 2011 with a 22 percent greater balance in our savings relative to a year ago. This is due in part to increased conference attendance, which this year was up by nearly 20 percent as compared to last year, and also reflected, in part, a rebalancing of conference participation towards non-ASCE members. A large number of our total conference participation were first-time participants and visitors from abroad, including from Cuba, Venezuela, Canada, Belgium, Spain, France, and other countries, all of which are encouraging for ASCE. In addition, there was broad media coverage, with nearly a dozen press representatives covering the conference. Finally, ASCE was proud to support our student participants, who visited us from various parts of the United States.

In most years, the conference runs a small budget deficit, i.e. the direct revenue from the various participation fees fails to fully cover the conference costs. This deficit largely reflects costs that ASCE assumes as part of its mission, which include student participation, subsidized participation for special situations (such as bringing speakers from Cuba) or economic hardship, and other assorted costs, for example, from journalists. Nonetheless, despite broadly similar revenue collection in 2011, we managed to reduce the conference related deficit by 31 percent relative to 2010 (i.e. from a deficit of \$4,131 in 2010 to a deficit of \$2,825 in 2011). This deficit reduction was achieved by (i) cost reduction through expenditure rationalization and re-optimization, (ii) raising extra-ordinary revenues earmarked for certain aspects of the conference, such as financing scholars visiting us from Cuba, (iii) charging separately the costs of the printed volume, and (iv) the heightened interest from non-members in this year's conference.

Membership renewals for the year starting July 1, 2011 have totaled \$14,684 so far—excluding the student category—comparable with the \$15,022 collected up to the same period in 2010. The average non-student contribution is above \$110 per member; the median contribution is \$90. We will begin our efforts this fall to remind our membership to renew, and in this connection, we have attached a renewal form for your convenience to the end of the newsletter, and continue to accept credit-card payments online at our website, www.ascecuba.org.

Sincerely,

Geni Gomez



From the ASCE secretary

Dear Friends,

The members of the ASCE Board would like to thank you for your continued support over the past year. As always, we are grateful for your insights as to how we can improve and strengthen our organization. ASCE's 21st Annual Meeting came together quite nicely with many panelists representing a very broad spectrum of opinions.

Thanks to our outreach efforts several former members decided to join us again. We also have a new website with a brand new logo that facilitates online membership payment. We hope this option encourages more Cuba-watchers to join, especially those from abroad that have so many post-Communism experiences to share with us. ASCE is also now more connected than ever through Facebook, LinkedIn and Twitter.

Carlos Díaz-Alejandro Lecture speaker Carmen Reinhart drew a large crowd in Washington, D.C. and was well-received. Many have said it was one of her best presentations to date. Those of you who attended this year's Annual Meeting know that Carmelo Mesa-Lago also did not disappoint as our Keynote speaker. The survey we distributed to gauge your thoughts on ASCE also indicated that we enjoy a high rate of member satisfaction. Thank you!

Best wishes,

Tania C. Mastrapa

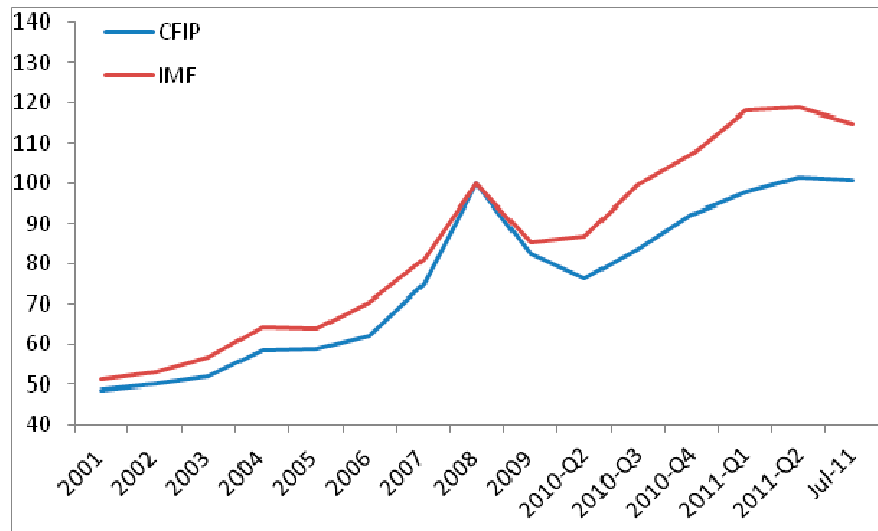
Cuban Food Import Prices Stabilize but Futures Suggest Short Relief

By Luis Luis

Cuban food import prices moderated in July 2011 driven by a 10 percent decline in wheat and modest weakness in corn and coffee. The ASCE Index of Cuban Food Import Prices (CFIP) fell in July 2011 by 0.8% below prices in the second quarter. In comparison the Index of Food Commodity Market Prices of the IMF fell 3.3% in the same period. This reverses the pattern that Cuban food imports are more unstable than the broader food commodity index compiled by the IMF as a result of including less correlated commodities such as vegetable oils and beef in the Fund index. Any decline could be welcome news for the Cuban population where foodstuffs account for a large proportion of household outlays as long as official stores pass along savings to the public.



Figure 1. ASCE Index of Cuban Food Import Prices



The good news notwithstanding, the respite in food import prices could be short lived. Future prices quoted in the Chicago Mercantile Exchange (CME) for cereals and coffee signal renewed upward pressures on prices in the next year. Other than dry milk prices, which comprise the bulk of Cuban dairy imports, wheat, corn, rice and coffee futures show an upward trend of roughly 5 percent to 11 percent between September 2011 and July 2012 futures contracts. We have not attempted to establish the precise correspondence of futures price movements to the ASCE index, as CME prices do not exactly match the commodity prices used in calculating the ASCE index. An approximate calculation suggests a 2 percent increase in Cuban food import prices between September 2011 and July 2012 on the basis of futures contracts as of August 12.

Futures Contracts Prices (CME)

	Sep-11	Dec-11	Mar-11	Jul-11
Corn	100	101.8	103.7	104.7
Wheat	100	104.2	109	111.5
Rice (rougl	100	103.5	105.3	108.3
Milk (dry)	100	94.6	93.9	82.3
Coffee	100	101.7	102.5	102.9



Change in Cuba? The 2011 ASCE Conference

By Paul Meo *

The early August meeting of the Association for the Study of the Cuban Economy (ASCE), held in Miami, was different from some of the more recent ones. First, there were few, if any, papers presented on the "Transition" in Cuba. Partly because the Castro brothers rival Adenauer in longevity, partly because there is nothing novel left to say, and partly because the proposed governmental changes are more interesting, the academics, retired Bretton Woods institutional staff, consultants, bureaucrats, and others who make up the membership decided the Transition was not a priority. Secondly, there were far more defectors, at least recent ones, than before. It was jarring for me to encounter a Cuban who had been head of an agricultural brigade in the People's Republic of Yemen while I had been there on a World Bank mission.

Some Cubans sent their papers via the internet, and there was even one--who presented an apolitical paper--who had been given an exit visa to attend the conference. There seemed to be far better information available on what was happening in Cuba, although the modelers and other theoreticians continued to successfully ignore reality when necessary.

Last November, the authorities issued some 270 "Lineamientos" (guidelines) to be considered by the VI Party Congress. The Congress met in April, after almost a dozen years of hiatus, and spent a whole day reviewing and approving the guidelines. In the event, with changes and additions, about 300 "agreements" were published, and these will serve for the restructuring of the Cuban economy over the next few years.

Many of the agreements were hortatory--demanding better discipline, more unity, better efficiency, etc.--and others were mildly inconsistent--expanding the private sector (the word "private" is still verboten in Cuba; it is called the "non-state sector") while increasing taxes on it massively--so the more sensible presenters (and I) concentrated on the few that might make a difference.

For years; indeed, shortly after the departure of Fidel from the scene, the ASCE consensus has been that Raul and company would produce very little change in the Cuban economy. This has been true since 2005; very little has indeed changed. Things may (I say "may" with reason) change in the future, but not really because of the VI Congress agreements.

There are some important decisions among the trivial.

First, the decision to downsize the public sector workforce by 500,000 has been validated by the Congress. While the timeline of March 2011, has not been met (only about 250,000 have been

* This is an abbreviated advanced version of the upcoming piece in the Papers and Proceedings.



shed), the new timeline of end-2011 has been agreed to by the Congress. Indeed, further downsizing was also agreed, with a total of 1.8 million to be shed by end 2014. While all sorts of barriers can be foreseen--military objections (the military now run the majority of public enterprises), slow generation of non-state jobs, bureaucratic obstacles--the Cuban regime has decided that government employment will not be the answer.

Secondly, while the famous 178 "own account" non-state activities were expanded to almost 200, and even within their context expanded (e.g., "paladares" (private restaurants) can now have places for up to 50, from 12), and non-family members can be employed in some activities (particularly private agricultural ones), there was no permission granted for establishing small, private businesses. Hence, most private sector expansion must be in small service activities (small restaurants, barber shops--which the state has now turned over the barbers, entertainment activities, beauty shops, taxis, etc.) and not in even relatively (say, 50 employees) small businesses. Even the professions--law, accounting, etc.--remain verboten for the private sector. It is hard to see how this can generate sufficient employment for over one third of the public work force to be downsized by 2014!

Thirdly, the Congress agreed to allow private ownership of housing; this to begin by the end of this year. This will obviously have a major effect, since mortgages, inheritance expectations, and construction will be massively affected if (IF!) the housing decision is liberally interpreted. Stay tuned for this one.

Finally, the Congress validated and encouraged an acceleration of "usufruct" standing for farmers, whereby they can decide what, when, and how to produce on land they are granted tenure for. But there was no decision to grant title to the farmers, and the need to accelerate the turnover stems from the desultory process used so far. (One speaker asked how you translate "usufruct" into plainer English; I suggested "sharecropper" since the resemblance to that is amazingly close). Pari passu with these output changes, there are others that will greatly affect Cubans. The Tea Party has hit Havana; government expenditures are being greatly curtailed. The ration book has been greatly condensed; many cheap products are now only available on the "market" or black market. Many state firms had canteens to feed the workers; most are being closed. Pensions will not be nominally increased; they have been declining in real terms for years. The education budget has been cut, and the need for foreign exchange has led to many doctors being sent abroad. While Raul promised recently to expand medical education and focus more on domestic medical services, they are now so abysmal that hospital patients are dying of neglect and even malnutrition.

But not all the Tea Party program has arrived; taxes have been increased. Many Cubans pay one third of their income in taxes, and "own account" workers pay far more. (The minimum salary--which is relatively close to the average-- is now about US\$17-18 a month!)

The Congress was also an obvious attempt by Raul to institutionalize what has been so far a family-run dictatorship. Party procedures have been restored, empty positions filled, and new faces abound (Raul recently replaced all of the provincial governors with younger stalwarts). By keeping 70 percent of the public sector management within the military, Raul probably also expects he can



force implementation of his changes more quickly; he publicly stated he wants to move from chaos to socialism (where has he been the past 52 years?).

Now, on the face of it, these changes are both partial and disappointing. While Cuban data continue to show a relatively buoyant economy, independent estimates indicate per capita income is still below that of 1989, the fiscal position is abysmal, and the external situation even worse. Cuba's recent sugar harvest, for example, was the worst in a century. Tourism, the chief export earner, has been relatively stagnant for three years, as has Venezuela's financial support. In spite of the agricultural reform--begun two years ago--food production remains stagnant. Cuban debt arrears continue to grow, and the country is "off cover" for all but the Chinese, Brazilians, and Venezuelans. The only growth item comes from Obama's decision to allow unlimited remittances and visits by Cuban Americans.

The economy confronts three major structural problems: the state enterprises are mostly dysfunctional; Cuba has extremely low, overall productivity; and gross investment--after years of being negative on a net basis--is still barely above depreciation levels. No sane person expects "taking in each other's laundry" will reverse these, let alone generate enough productive jobs to absorb the over third of the public workforce being fired over the next three years. But. But I believe change (or "informal" reforms) may accelerate. First, one has to realize that Cuba is no longer a "hard state" when it comes to economics. Corruption is rampant; so rampant that virtually every head of a foreign-linked sector--Cubana airlines, tourism, tobacco, rum--has been convicted of corruption. Even Pedro Alvarez, once the all-important head of ALIMPORT who used to negotiate deals with US farm groups and state Governors, has been tried and convicted. (Like most Cuban officials, on release from prison he headed for the US; he now resides in Tampa.) To understand how irrelevant the VI Congress is, simply click on www.revolico.com and note the many homes "for trading." While you can barter homes for homes, it is illegal to include cash or other payments in the deal. This is done openly with no (yet) punishment. Given the tax burden on "own account" workers, few register or pay taxes; or rather they pay only nominal sums to the block warden of the "Committee for the Defense of the Revolution." Tips are now illegal in resorts patronized by foreigners. This is treated as a joke. Prostitution abounds; crime is rampant; education, health, and other vaunted public services are often provided only after bribes. Pandora's box is now open. Recent foreign observers quickly note that there is less obedience of even the most sacred laws; folks openly disparage the government; and there seems to be greater economic freedom than ever. Understandably, while--as noted above--the formal statements still genuflect to Marxism, there is far less rhetoric about the glories of socialism as the social safety net is reduced, public workers are fired, and 52 years of that persuasion have ended in economic disaster. Fidel is now history. Alive, occasionally writing columns on world events, and trotted out to embrace Chavez (and visiting US Senators), he is otherwise ignored on policy issues. All those linked to him and of less loyalty to Raul are now gone.

A cynic would remind us (and one did) of the reforms of 190-85, and of 1993-95, when the economy confronted disaster. As soon as the challenges were ameliorated, the "reforms" (far more



timid than those now underway) were reversed. But there now seems no savior in sight. Whatever happens to Chavez or Venezuela, it is obvious that Venezuelan subsidies will not increase. The state enterprises remain among the least productive in the world. The authorities have recently increased taxes on tourism. The declining infrastructure and desultory service mean that Cuban tourism sites are now fairly uncompetitive with other Caribbean spots, let alone the now cheaper Florida options. In spite of the agricultural reforms, including the closure of two-thirds of the (inefficient) sugar mills, agricultural production continues to fall.

Thus, I--for one--believe the move towards a market economy is now irreversible. The corruption combined with the desperation of Cubans will quickly expand the private activities from legal to illegal micro-enterprises (already occurring) and then to small and medium-sized firms. One example; a recent traveler to Cuba noted that one private restaurant had valet parking, a singer, and other ancillary attractions. All are still illegal. Timid house ownerships regulations, when they come at the end of the year, will likely lead to a total freeing of the housing markets. Banks may now lend directly to people; while they have yet to do so, I expect this to accelerate once the bankers receive the appropriate incentives--bribes.

Then there is the recent and massive increase in immigrant remittances and travel by US citizens to Cuba. I did not write "Cuban-Americans" because it is clear the Obama Administration will let anyone travel to Cuba. In the last year of the Bush Administration there were 1500 citations sent to Americans for illegal travel to Cuba. Since Obama took office there have been 19. One of the student papers presented included anecdotes from a recent tourist trip to the island. Foolishly, I commented to some Cuban-Americans that the student must have been Canadian since she was not of Cuban origin and her trip was--as noted--pure tourism. I was immediately deluged with example after example of travel by ordinary Americans as simple tourists; the travel agencies which package the tours are often forgetting to include the "research" or other legal reason for the trips. Canada has replaced Spain and Italy as the most important tourist provider as Cuba increasingly deters "immersion" tourism (i.e., city-tourism, where linguistically capable Italian and Spanish tourists can mingle with ordinary Cubans) and concentrates on resort tourism. And the US is fast becoming one of the top five tourist providers.

Since the US already ranks fourth in Cuban merchandise trade and provides two thirds of the remittance flows, you can quickly understand how the "blockade" is working. And these flows have led to some interesting results. Micro-credit is now available to Cubans; a system has arisen by which a family member in the US guarantees the credit and the Cuban then receives the loan. Remittances were the source of over half the "own account" activities surveyed last year. And illegal housing purchases are often made by proxies of Cuban Americans buying retirement homes. Farmers expanding their new "usufruct" activities often can do so only because of immigrant remittances.

While all this will lead to steadily deeper and more helpful "reforms" (actually, the expansion of the informal economy, with legality hopefully following after a lapse), there seems little reason to



expect a major or significant shift quickly. Chavez' health, the continued role of state enterprises, the uncompetitive nature of the overall economy, remain.

Cuba is very likely to find significant deposits of oil. A Norwegian fifth-generation drilling vessel costing \$750 million was launched in Singapore recently and hired to drill north of Havana by Repsol and other European (and Chinese) firms. It cost \$450,000/day and will likely make five to seven attempts. You don't spend that kind of money unless you are reasonably certain something will turn up. But even the most optimistic estimate of Cuba's possible reserves indicates Cuba might become self-sufficient (it consumes under 150,000 bbl/day) in the longer term; and if oil is found next year it will be five years before it becomes available. The Venezuelans and Chinese are building two 150,000 bbl/day refineries: one on the south coast near Cienfuegos (actually, this is being renovated and expanded), another on the north coast for processing Chinese crude from South America. These, however, are projects that will both take a few more years to complete and offer few jobs and little foreign exchange (refining is the least profitable of petroleum activities; and off-shore ones are notoriously parsimonious to their hosts). Cuba now has agreements with over 90 countries to provide medical professionals. From Pakistan to South Africa, from Qatar to Bolivia, Cuban doctors and nurses labor at Cuban salaries (about \$20/month) while the host governments pay 10 times or more to the Cuban government. (This, of course, violates a series of ILO agreements, but as usual the "international community" ignores it.) Most--probably 30,000 out of 50,000--are in Venezuela and likely ensuring Cuba receives free oil (in fact, Venezuela should charge \$27/bbl, but since Cuba never pays it is free). Given the effect exporting doctors and nurses has had on the domestic health scene, Raul has announced he will be expanding Cuba's doctor-training capacity to 100,000/yr. (This compares to about 2/3 that in the US, and is probably as credible as the 10 million to sugar harvest attempted years ago!) Nevertheless, this income will likely grow in the future, although it will depend on finding new markets for the doctors/nurses... Finally, the usual cautionary note. While I am quite convinced the move towards economic markets is virtually irresistible, if chaotic and "illegal" in most cases, I have no crystal ball on its effect on Cuba's political scene. Raul continues to beaver away, institutionalizing the dictatorship in the hope it will last when he and Fidel are entombed. The military remains strongly in control of both the economy and the government, if complemented by some younger civilians in provincial posts. And Cuba's police remain as effective as ever--using access to education, other social services, rationed food, etc.--in controlling most dissent before it becomes public. The Arab Spring has not hit Havana. But the desperation of Cubans, the increasing policy conflict between downsizing public work forces and limiting the growth of alternative, private work alternatives, and the likely departure of Chavez, Fidel and Raul from the scene could lead to a revolution. An ex-Diplomat privately noted that the political scene seemed far more fragile today than it was when the USSR withdrew its support. We'll simply have to wait and see what happens.



The Cuban Economy and Reforms

By Joaquín Pujol[†]

Introduction

For quite some time the Cuban economy has been facing a number of economic problems. There has been minimal recovery from the near 80 per cent collapse in the population's real income levels since the suspension of the subsidies provided by the Soviet Union in 1989, in fact the official wage rate remains at about 25% of its 1989 level (See Chart 1). For most of this period economic policies were the result of the whims of Fidel Castro and dominated by political rather than economic considerations. As a result, the de-industrialization that has taken place brought industrial output in 2010 down to about one half of its 1989 level. Sugar production, which used to be the mainstay of the economy, declined catastrophically, from roughly seven million tons in the 1980s to barely over one million tons per year at present. Reduced production of foodstuffs as a result of the agricultural policies implemented resulted in major increases in food imports. Investment, at about 8 ½ per cent of GDP (compared with almost 22 per cent on average for Latin America) was insufficient even to replace the growing obsolescence. This situation has brought about serious deficiencies in a number of areas.

The main ones have been:

1. Inability to produce enough food to feed its population.
2. Very low productivity (particularly low labor productivity of the state sector)
3. Exodus of the young in the face of a significant aging of the Cuban population
4. Dilapidation of the stock of housing and lack of appropriate replacement
5. Deterioration of the overall country's infrastructure (transportation, roads, railroads, ports, airports, water distribution and drainage systems, etc)
6. Large fiscal deficits covered by monetary injections
7. Large balance of payments deficits which have resulted in suspension of the payment of external debt obligations
8. Dependence on imported energy and on foreign assistance
9. Prevalence of an overvalued exchange rate and a complex multiple currency system that makes it nearly impossible to determine the real profitability of various economic activities and results in all kinds of hidden subsidies and other economic distortions.
10. A decline in the quality of healthcare and education

Since the beginning of 2009 the Cuban government found itself in a jam as the problems listed above intensified, and the rulers of Cuba faced the worst economic crisis in decades. The Cuban Government became cash-strapped due to the lack of domestic production, the impact of three hurricanes that went thru the island in 2008, the global financial crisis, lower tourism revenues, and

[†] This is an abbreviated advanced version of the upcoming piece in the Papers and Proceedings.



declining earnings from nickel and other exports. Food production kept falling; the sugar harvest dropped to the lowest levels in a century; international sources of credit dried out; and only the billions in subsidies from Venezuela's Hugo Chávez kept the country afloat.

In response, the government resorted to cutback in imports, freezing the foreign currency deposits of foreign firms investing and exporting to Cuba, and began to run into arrears in the settlement of its international financial obligations.

But Cuba had much more than an economic crisis. Its state-controlled, centrally-managed economy became virtually frozen and badly in need of change. As the government became increasingly unable to meet the basic needs of Cuban citizens, many individuals fled the country and those left behind had to turn to the black-market, where products-- often stolen from the state or sent in from abroad by the exiled community-- are bought and sold.

Under these circumstances the authorities saw the need to engage in a number of significant policy changes. Observers of the Cuban economy have been looking with interest at these changes and in this Conference you will have a chance to hear the opinion of some of them as to the appropriateness of the policies adopted to handle the various problems faced.

What is the government doing to try to resolve these problems?

Since taking over from his brother, Raul Castro acknowledged that the Cuban economy was not functional and that there was a need for important structural changes. At the beginning he moved slowly while he consolidated his control over the political machinery of the government, probably fearing a negative reaction from those members of the nomenclature that were likely to be affected by these changes. The efforts were concentrated on cutting waste from the government and state enterprises and in seeking to promote import substitution and to cut the consumption of expensive imported energy. At the same time, he undertook a purge throughout the governing structure of individuals that may not follow his leadership, placing an increasing number of members of the military in key positions of the economic structure. More recently he has taken what are seeing by some as bolder steps to seek a reform of the system.

A number of measures have been taken to scale back the state's near-total dominance of the economy, while attempting to generate new revenue for a government short on cash. The plan includes bringing out of the shadows illegal private businesses already operating and taxing them, leasing fallow state lands to private farmers, loosening of regulations on farmers selling directly to consumers instead of to the state, issuing micro credits to some farmers for purchasing farming equipment in authorized stores - rather than on the black market, adjusting salary scales to be more responsive to individual productivity of the workers and eliminating the caps on earnings, cutting back on employment by the State and on generalized subsidies, granting new licenses for family businesses and other self employment activities to be able to operate legally, and promotion joint



ventures with foreign investors under the control of the State in those activities that are most profitable, such as tourism, mining, and oil exploration.

Some observers consider that these are important steps in the right direction; others think that the steps are too mild and too late, and they will not be adequate to bring about a solution to the current crisis.

Comments on some of the measures adopted

Changes introduced over the past year, including the right to work for oneself in 178 approved jobs, has been billed by some as a wide new opening for entrepreneurship, on an island of 11 million people where the state employs more than 90 % of all workers and controls virtually all means of production.

In reality, many of the new jobs, everything from food vendor to wedding photographer, manicurist to construction worker, have existed for years in the informal economy, and many of those seeking work licenses were already offering the same services under the table. As of the end of 2009, there were already 143,000 licensed self-employed, although thousands more worked for themselves illegally. Moreover, about two-thirds of the 171,000 new business licenses granted so far this year went to people who were already out of work, suggesting that the vast reforms may not be enough of a safety net for the half-million people who are expected to be soon out of a government job. The new measures give these individuals the opportunity to legalize their activities, but to do so they must register with the government and be subject to taxation. The liberalization measures are designed not only as an attempt to create job opportunities for individuals being left out of employment by the State, but as a way to try to control the black market and capture some additional revenue for the government. Paradoxically, the expansion of a legal free market might result in an increase in the size of the black market, particularly for the goods and services the new entrepreneurs need to survive to the extent that the government is unwilling or unable to supply them.

The number of authorized self employment activities is still very small and any activity not listed is forbidden and illegal. In particular there are no professional activities included, nor any activity involving sophisticated technologies. The existence of many very detailed and strict rules that regulate the permitted activities leaves little room for personal initiative and the continued presence of price controls is a disincentive to increased production. Non observance of these rules can make the person subject to high fines and/or suspension of the authorization to carry on the activity. This tends to promote corruption.

Cuba plans to turn some small-scale manufacturing and retail services into cooperatives as the state retreats from minor businesses in an effort to boost the island's troubled economy. The new framework also says that the new co-operatives could function as mid-sized companies with many employees, a key requirement of any vibrant economy. Currently, such entities only exist in the



field of agriculture. The newly released version of the guidelines allows such employee-owned businesses to directly sell products to consumers or business owners, without the state operating as an intermediary. The co-operatives would also be free to decide how much each worker gets paid - presumably in relation to their productivity and usefulness. However, the state will still own the cooperatives' premises, as it does most things in Cuba, but the workers will be allowed to run them, pay operating costs and taxes and keep the profits.

To help address the housing shortages the Government has announced that they will authorize licenses to allow self construction of private housing by individuals. But while some bureaucratic hurdles will be eliminated, meaning transactions can be notarized and completed without having to seek prior authorization, and family members will be able to inherit property even if they are not living at the address, individuals will still not be allowed to own more than one home, the sales will be taxed, and individuals will have to prove that the money for the transactions comes from legitimate activities.

Changes in the social safety net

As part of the reforms, the government has been trimming its social safety net, warning Cubans that the country's cradle-to-grave entitlements — from free education to health care to subsidized electricity — can't be sustained by current levels of economic output. Even the island's ration book, a keystone of Cuban socialism, is being winnowed away amid rumors it may be eliminated altogether. The level of "real wages" (inflation-adjusted) in the official economy collapsed after 1989 and have not recovered significantly since then, according to estimates from the *Centro de Estudios sobre la Economía Cubana*. Although the official wage rate remains at about 25% of its level of 1989, some people have other sources of income, such as remittances, legal self-employment, home produced goods and services, economic activities in the underground economy, income supplements from the foreign operated joint-ventures, goods in kind distributed by the State, and widespread pilferage. Throughout the last two years, the government has taken a number of steps to reduce local subsidies and introduce new taxes in order to reduce the fiscal deficit. This has involved dropping a number of products from being made available at subsidized prices through the "rationed family basket" ("libreta de abastecimiento"). As a consequence, Cubans have seeing their ration cards get thinner and thinner. The cutbacks in state subsidies over the past year -- especially in the rations cards that provide limited but deeply discounted supplies of food and a few other items to Cuba's 11.2 million people -- already have increased the cost of living. Hit especially hard have been retirees, the disabled, widows and others who live on fixed incomes, and the 40 percent of Cubans who don't receive remittances from relatives abroad and must rely on salaries that officially average a mere \$20 per month.

The Tax System

One way in which the government expects to be able to generate more resources for its operation is through the tax system.



The tax code recently announced introduced new taxes that will have many Cubans paying more than a third of their income to the state, while those who create businesses and hire their own employees will pay even more. Rules recently published detail four kinds of taxes for the private sector: a sliding personal income tax, a sales tax, a public service tax and a payroll tax. It also establishes minimum monthly fees for different kinds of businesses, as well as deductions Cuban can take to reduce their tax burden.

This new tax regime represents a minor improvement over the previous one in that it permits the deduction as costs of production of more than a maximum of 10% of total revenues, as was the case previously. This is a reasonable adjustment to the tax base as most of the self-employed activities generate costs that are higher than the maximum allowable 10% of total revenues. The new regime is especially beneficial for activities such as gastronomic, transport and handy-craft or artisans, activities for which input costs are likely to be far beyond 10% of total revenues. However there are a number of flaws in the taxation regimen which will continue to stunt the development of small enterprise and will prevent the absorption of the redundant workers being displaced from the public sector.

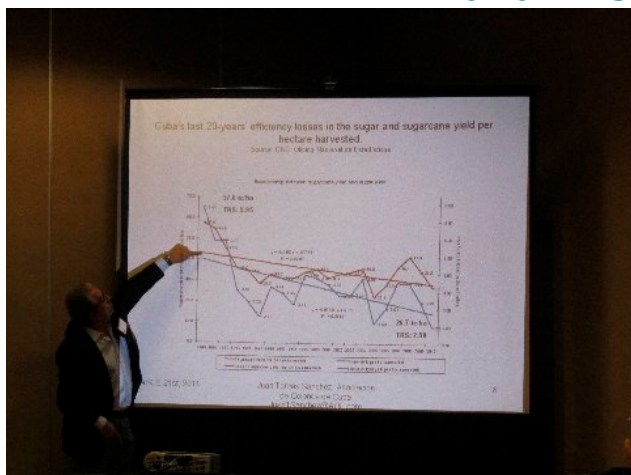
The timid revisions of the tax regimen will not facilitate job creation in the microenterprise sector because:

- The high level of taxes generally will discourage enterprise creation and legalization of those that have been operating as part of the black market.
- The underground economy and corruption will continue to be encouraged by the prevalence of State controls.
- The tax on the hiring of employees will discourage the absorption of labor into microenterprise activities.
- Microenterprises will remain stunted by the high effective tax rates that are incurred when costs of production exceed the minimum deductible for tax determination purposes.
- Many private activities for which there is a large demand (especially those involving professional and technical knowhow are still prohibited)

In addition, there continues to be a tax discrimination favoring foreign firms in joint ventures. The main difference is the determination of the effective tax base which is total revenues minus costs of production for foreign firms, but for micro-enterprise is gross revenue minus an arbitrary and limited allowable level of input costs. The result of this is that the effective tax rates for foreign enterprises are reasonable but can be unreasonable for Cuban microenterprises, where the effective tax rate could reach and exceed 100%.



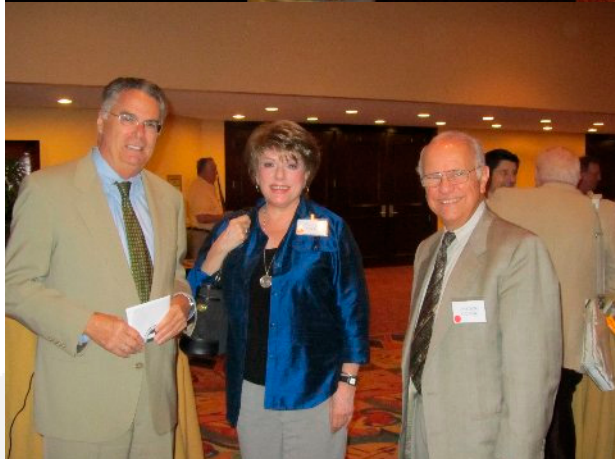
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