The Historical Development of the Cuban Banking System: Lessons for the Future

Raúl M. Shelton, St. Thomas University

Until the l9th Century, credit functions in Cuba, under Spanish domain, were performed by merchants who provided unsecured credit to sugar, coffee, and other producers. Between the early and mid-1800 however a number of single purpose establishments appeared in Cuba. The first bank established was the Banco de Fernando VIII, established in 1832 and which lasted ten years. As befitting a Spanish colony, these banks were founded by Spaniards, as opposed to the "criollos" born in Cuba.

In 1842 the "Caja de Ahorros" was established, followed in 1854 by the "Caja Real de Descuentos," which in 1856 became the "Banco Español de La Habana." On May 1, 1857, the "Banco de Cuba" was founded in Santiago de Cuba, after which a number of banking institutions were established. In 1859 there were 15 financial institutions on the island with a capital of US $22.4 million.

By 1863 Cuba had developed various other credit institutions, such as the "Caja Agrícola de Cárdenas," "Banco Agrícola e Industrial," "Caja Mercantil de Matanzas," "Crédito Industrial y Mercantil de Pinar del Rio," and "Ba nco Mercantil de Santiago de Cuba." The list of financial institutions continued to grow, slowly but continuously. The banking development ground to a standstill during the banking crisis of 1866, aggravated by the total lack of credit regulations and t he inexperience of the bank managers. The only survivor was the "Banco Español de la Isla de Cuba."

During the revolutionary periods, the Ten-Year War and the War of Independence, the banking system remained stagnant and it was not until the end of Spanish rule in 1898 that the Cuban Banking system began its resurgence. Although the two most import ant banks were the "Banco de la Isla de Cuba" and the "Banco del Comercio," several other banking houses, such as Gelats y Cía., Upmann, Zaldo and Simón y Cortés had been established and began to flourish. Most merchant banks operate d in the British Merchant Bank fashion, most of them created by Germán and English immigrants. They later evolved into regular commercial banks. Zaldo would eventually become "Banco de la Habana" and later still, the First National Bank of New Yo rk.

During the early Republican period, and after two United States military intervention, European and Wall Street interests remained predominant in Cuba. Through 1914, while the U.S. dollar was used for most official and foreign transactions, the Fren ch "Luis" and the Spanish "Centen": gold pieces continued to be used in local trade. Coinciding with the beginning of the First World War, Cuba promulgated the Monetary Law of 1914, drafted by Leopoldo Cancio, which established that from there on the new ly issued Cuban peso and the U.S. dollar would be the only national currencies. The law, known as the Economic Defense Law, proposed by President Mario García Menocal, established a Cuban Monetary System and is considered Cuba's first significant monetary legislation.

Decree 1577, signed on November 24, 1915 determined the manner in which the Spanish and French gold pieces would be retired from circulation and replaced by national currency. The new law established that the national currency would exist in coin, w hile the U.S. currency would circulate in both coin and paper. The Cuban currency was to be backed by gold and rapidly appreciated with a premium reaching 3 per cent over its exchange in value in U.S. dollars. The strength of the Cuban peso notwithstand ing, the U.S. dollar remained through 1932 almost the sole medium of exchange in Cuba. In 1924 the dollar represented 87 per cent of the monetary circulation in Cuba.

Between 1898 and 1920 several foreign banks (mostly American and Canadian) as well as domestic banks were established in Cuba. Between 1915 and 1920, thirty seven local banks were established primarily to finance the booming sugar industry brought a bout by the end of World War I. These private banks included the "Banco Nacional de Cuba," Banco Central de Cuba," and the "Banco Internacional." All were private institutions at that time and not to be confused with future official government instituti ons.

In 1919, the "Banco Nacional de Cuba," with 130 branches throughout the island, had a net worth of US$14 million and deposits of US$195 million. "The Royal Bank of Canada" and the "First National City Bank of New York," had 46 and 15 branches respec tively, mostly financing the Cuban sugar industry.

The skyrocketing rise in the price of sugar, in early 1920, brought about what was to be known as the "dance of millions." With the end of wartime controls in the U.S., the price of sugar rose from 7.28 cents a pound in November, 1919, to an all-tim e peak of 22.5 cents in May 1920. The Cuban sugar crop of 1919-1920 was sold for over US$1 *billion*, and brought more money than that provided by all other crops from 1900 to 1914. The "Sugar Mentality" that was to dominate Cuba's economic thought grew in strength. The sugar companies borrowed heavily to expand production and the banks were ready to accommodate them. When the European beet production recovered, the price of sugar dropped to 1.8 cents per pound in 1921. Many Cuban-owned sugar pr oducers, heavily leveraged, went into bankruptcy and their interests were purchased by U.S. interests and by foreign banks. The Cuban-owned banks, which had provided substantial loans, backed by sugar, became insolvent. No specific banking regulations e xisted. Banks in Cuba were regulated by the provisions of the Commercial Code, totally "demode."

The magnitude of the problem forced President Menocal, who had done nothing to prevent the downfall of the Cuban banks, to issue Decree 1583 on October 10, 1920, establishing a one-year moratorium for payments (extended twice), but the measure could not prevent the inevitable: the Cuban banks existed no longer, with very few exceptions, and the larger the U.S. and Canadian banks, with their strong parent companies, were, for the most part, the only survivors. Foreign banks dominated the Cuban bankin g system. They held, in 1939, 838 of the total deposits in Cuba.

Despite the recommendations contained in several noteworthy studies between 1914 and 1940 by Alonso Pujol, Celso, Cuéllar, Rogelio Pina and Joaquín Martínez Saenz, regarding the need for a Central Bank in Cuba, it was the Constit ution of 1940 which provided for the establishment of a National Central Bank. The Banco Nacional de Cuba was officially established by Law XIII, signed by President Carlos Prio Socarrás in 1848, although it did not begin operations until April, 1 950. The Banco Nacional had the functions and powers normally associated with modern central banking institutions. It acted as a banker's bank: it was the fiscal agent of the government, a regulatory institution and was Cuba's sole bank of issue.

On December 20, 1950, the Cuban Government established the national credit bank, BANFAIC (Bank for Agricultural Industrial Development), in an effort to provide funds for diversified investment in industry and agriculture, and to provide small farmer s with credit at a reasonable rate. Between 1952 and 1955 several other official banks were established in Cuba: "La Financiera Nacional," in 1953; BANCEX (Cuban Bank for Foreign Trade); BANDES (Bank for Social Economic Development); and the FHA (The Mortgage Insurance Institute).

By 1950, Cuban-owned banks achieved a position of predominance in the banking field. By 1959 there were 49 commercial banks with approximately 200 bank offices. Most of the principal banks were centered in Havana. Only six foreign banks remained, three US-owned: the National City Bank of New York, the First National Bank of Boston, and the Chase National Bank (later named the Chase Manhattan Bank). The other three were: the Royal Bank of Canada, the Bank of Nova Scotia, and the Bank of China.

By the end of the 1950s, the banking system in Cuba was contributing significantly to the economic development of Cuba and had been instrumental in placing Cuba at a take-off point towards sustained growth. The banking system was a dynamic and growi ng sector of Cuba's economy and by 1958 Cuban-owned banks controlled 60 per cent of total bank deposits or approximately $932 million pesos, then at par with the US dollar.

After 1958, with the Castro regime, the commercial banking system of Cuba ceased to exist. The 1960 Bank Nationalization Law was issued by the regime. Promulgated on June 1, 1960, Law 851 authorized the executive branch to expropriate all business enterprises, including banks belonging to citizens of the United States. On September 17, 1960, the Cuban government confiscated all the branches of the National City Bank of New York, Chase National Bank and the Bank of Boston. This was followed on Oct ober 13 by Law 891 which nationalized all Cuban-owned banks on the island. The Bank of Nova Scotia and the Royal Bank of Canada were the only banks able to make special mutually acceptable compensatory arrangements with the Castro Government before their Cuban operations were closed in December 1960.

The banking system in Cuba under Castro has been patterned after those of communist regimes, as well as in the former Soviet Union. After the appointment of Ernesto (Che) Guevara to the position of President of the National Bank, events conducive to the admission of Cuba into the Soviet Bloc unfolded at a rapid pace. Cuba signed a Trade and Payments Agreement with the Soviet Union on February 13, 1960; Cuba refused to participate in the Inter-American Development Bank, in which all other American Republics are stockholders, and Cuba withdrew from the International Bank for Reconstruction and Development (World Bank). The Castro regime destroyed its traditional geo-political ties which had always existed between Cuba and the Western World, while a t the same time firmly establishing economic and political connections with the Soviet Bloc, which was to finance Cuba's deficit with largesse.

Thus the Castro regime eliminated credit operations between enterprises; limited the circulation of money; regulated the use of money, and placed "bank money" entirely under the control of the National Bank to be used, in actual practice, only for th e purpose of granting credit to government agencies or government enterprises. The means of payment came under the total control of the government to be squandered in endeavors that were economic monstrosities. The banking system, with a total absence o f modern technology, systematically deteriorated. In 1984, in a timid

turn-around, the Cuban banking legislation permitted foreign banks to establish representative offices in Cuba. It appears that only one Spanish finance company has established an office under Decree No. 84.

The lesson to be learned from what has happened to the banking system in Cuba indicates that the banking system, if properly used and regulated, is a powerful instrument of economic development, but that it can only flourish in a scenario of a free m arket system under a democratic environment where competition dictates the use and price of money.

The most crucial stage in a post-Castro Cuba will be the transitional stage: the drafting and implementation of modern banking laws and the structuring of a modern banking system capable of creating a dynamic and profitable banking industry adequate ly regulated and supervised by a Central Bank. The types of banks that Cuba will require in a post-Castro Cuba will necessarily have to be consistent with the banking systems that have evolved in the Western Hemisphere and particularly in the United Stat es. The world's banking system is being increasingly globalized, and the new BASLE Guidelines for Capital Standards and Supervisory Principles is in the process of being implemented in about 80 countries. Technological advance and the need to serve mult inational clients have forced an expansion in different markets around the world and the banking system will have to liberalize foreign investment laws in order to benefit from the economic advantages presented by the competition offered by foreign banks.

Another lesson to be learned is the danger of permitting foreign banks to take the upper hand. During the weak and unstable transitional period, foreign investors will want to rush to Cuba to set up new banks. The Cuban banking authorities will hav e to have clearly define long term objectives framed in such a manner as to avoid the risk of mortgaging the future if significant deviations from these long-term objectives become a permanent mode of operation.

As recommended by the Cuban Banking Study Group, during the transitional period only certain financial institutions should be permitted to operate in Cuba, to ensure, basically, that foreign aid and emergency loans are being properly channeled. Thes e institutions, operating on an emergency basis, should have strict guidelines. Two possibilities are outlined in this study: one, the creation of a multi-nation consortia-type bank whose shareholders will be institutions having expressed an interest in establishing branches or subsidiaries in Cuba at a later period; two, the Federal Reserve Bank of Atlanta could consider the possibility of establishing a temporary emergency banking facility in various regions of Cuba to aid in the transitional period. Once a new government is freely elected and Cuba establishes its own currency and its own banking regulations, these Federal Reserve branches can be closed.

During the transitional period no foreign institution should be allowed to operate or open a branch or subsidiary in Cuba in the absence of a regulated financial market. This will prevent the debacle that has taken place in Russia.
There is a significant number of Cuban-American bank officers who are knowledgeable in modern banking techniques, and are capable of structuring a strong, independent and healthy modern financing of economic reconstruction of Cuba, servicing both the publ ic and the private sectors.

Obviously there are significant "provisos" for the realization of this optimistic statement: that Cubans learn the hard lessons of history; that the banking and financial industry operates in a concise regulatory framework, separate and independent from political influence; in an environment of political stability and democratic guidelines within the milieu of a citizenry with a "social conscience" and a deep desire to catch-up with the rest of the world.