

FINANCIAL SERVICES, POVERTY AND ENTERPRISE: THE CASE OF CUBA

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For the past fifteen years, as part of a broad effort to address directly the problem of widespread poverty, the international development community has focused on the impact that lack of access to financial services, faced by close to a billion poor people throughout the World, has had on their ability to escape poverty.

This discussion has emphasized the identification of the causes of poverty and the mechanisms that would place in the hands of the poor the means to achieve a sustainable livelihood. In practice, the effort has resulted in the initiation of dozens of new programs to develop institutions and methodologies designed to provide financial services to the poor. This paper is a first look at how these experiences might relate to current policy and economic conditions in Cuba. It also seeks to highlight what that experience might suggest for the shape of economic and social policy once transition begins.

WHY ARE WE CONCERNED WITH THE FINANCIALLY UNDERSERVED?

Without access to financial services, no one can hope to initiate or grow a micro or small and medium size enterprises (SMEs) that will produce income and create employment. In this sense, the development of microfinance systems lies at the very core of the fight against poverty and for economic and social development.

Microfinance systems, by offering people financial services they do not now receive, open a wide range of employment and income opportunities not avail-

able currently to them. One can observe the thousands of entrepreneurial efforts, truly “self-employment” enterprises, started by poor people with only meager resources.

WHY THE EMPHASIS ON MICRO AND ON SMALL AND MEDIUM SIZE ENTERPRISE (SMES)?

The reasons are several. First, micro and SMEs are labor intensive and generate more employment per unit of investment than large enterprises. Second, when directly managed by the owner, they have proven to be very efficient. Third, they are a very effective means of deepening a privatization process by making private entrepreneurs of thousands in the population. Ergo, giving, in this manner, more people a stake in society’s stability, growth, and well-being.

SMEs are also known for their agility in adapting to changing market and supply environments; their significant role in strengthening managerial and entrepreneurial skills; and their contribution to diversity and competition in the supply of products and services. It is worth noting that, when we say entrepreneurs, we tend to think of businesses outside of farming. In fact, farmers—small or large—are entrepreneurs and risk takers. The effects I mention have also been observed in the rural sector in transition countries, where agricultural land tenure rights have been transferred or sold to former rural state employees.

I believe that, by now, we are mostly familiar with the important role that micro and SMEs play in both the developed and underdeveloped countries. More than 50 percent of US firms are categorized as small and medium. They provide more than 50 percent of overall employment. Their relative numbers and employment creation roles are also important in many EU countries and Switzerland. In this last country, for example, more than 70 percent of the firms are very small—fewer than 7 employees—and provide the majority of national employment.

The same situation prevails in developing countries. For instance, in Chile, more than 65 percent of the firms—600 thousand—are micro or SMEs. They provide close to 70 percent of employment. I could go on mentioning country after country where data show how important micro and SMEs are in generating income, employment and wealth.

Without access to financial services to start a business or grow an existing enterprise, however, the prospective poor entrepreneur is not likely to succeed, whether in the United States or in a developing country.

WHAT ARE THE DANGERS?

The design of financial institutions must aim at making them financially safe and well managed. Corruption is always a major threat. In these institutions, because they handle the resources of the poor, avoidance of corruption is essential. One needs accounting and accountability systems that minimize that danger. Within the institution, record keeping should be simple, standardized, and transparent. Outside of the institution, there must be a regulatory and supervisory framework to ensure honesty and compliance with the law and with standard business practices.

Management is another important element. Management rules and procedures need to be standard, understandable, and clear. Policies and procedures covering loan underwriting and write-off, interest rate setting (on both loans and savings), the proper balance between liquidity needs and the structure of the lending portfolio, etc., need to be given careful and continuous attention and be transparent to all. Obviously, all of these elements apply equally to microfi-

nance institutions, larger banks, and all other financial institutions.

We know from experience that establishing and maintaining transparent and accurate accounting and management systems is possible in small institutions managed by local people, even where educational attainment of the population is limited.

ACCESS TO FINANCIAL SERVICES

Why is it that, even in developed societies, there are large population groups that are not served by existing financial systems? Why is it that financial institutions that generally seek investment and business opportunities neglect such a large potential market?

There are many valid reasons why well-developed financial institutions do not offer services to the poor: The poor are frequently geographically isolated. In addition, transactions are usually small and transaction costs are relatively high. Thus, dealing with poor clients may actually not be profitable for existing financial institutions.

In addition, poor people seldom have either collateral or an established credit history. These factors result in a high-risk profile that cannot be fully compensated by higher service prices. It is also difficult for a financial institution to assess a potential client's character and credit worthiness that could, in some cases, make collateral less necessary. Consequently, the poor client or customer is usually perceived as a bad investment or lending risk.

The challenge, then, is to develop methodologies and institutions that will overcome obstacles like these. Many current programs rely heavily on the collective wisdom and trust that can be found in small communities where people know each other well. Relying on such local trust and collective judgment can minimize lending risk. In addition, the use of modern information technology has proven helpful in reducing transaction costs.

Current approaches fall into several categories including "village banks," "solidarity lending," "financial cooperatives," and "small regional banks," as well as more traditional forms of community-led efforts

such as the rotating savings and credit associations (ROSCAS) and roving “savings consolidators.”

In all of these approaches, personal familiarity with the members of the financial groupings and collective repayment guarantees play a major role in lowering costs, reducing risks, and securing repayments.

WHAT KIND OF SERVICES DO POOR PEOPLE NEED?

Poor people are like anybody else. They need just about what any of us need. That includes credit, access to savings instruments, insurance services, and financial education. A person may need credit for a micro enterprise or for a family social or traditional obligation like a wedding or a funeral; a place to safeguard hard-earned income at risk; a place to learn how to keep books or how to calculate cost of production; a source of insurance products, either linked to financial transactions or to disease or death.

It is important to emphasize that, while many new micro financial institutions have started with the support of grants and donations from external sources, none can succeed in the medium to long term without achieving financial self-reliance. That means that they must cover all of their operational costs and generate surpluses to permit the build up of reserves for financial soundness and for growth. Otherwise, their impact would be limited to a very small segment of the population.

THE STATUS OF ACCESS TO FINANCIAL SERVICES IN CUBA

Poverty, under employment, and malnutrition affect a large proportion of the Cuban population. During the past several years, the extent of this penury has been identified by several studies prepared by the Center for the Study of the Cuban Economy of the University of Havana. The issue of existing poverty and lack of access to resources and basic goods have been also highlighted in 2006 in several speeches about corruption and socialism made by Fidel Castro, Central Bank's Francisco Soberón, and Economy Minister José Luís Rodríguez.

The main characteristics of the financial system available to Cuban citizens are unfortunately easy to describe. The state is the only source of financial services

for most Cuban citizens and most producers. The government owns or controls most of the country's assets, most agricultural lands as well as other productive capacity. The state budget is the main mechanism for credit services to these users. Moreover, according to government sources, most Cuban state owned firms, whether corporations or socialist style cooperatives, are subsidized by the budget, as they seldom cover their costs. In addition, those firms are allowed little freedom in making their own financial or other decisions.

Part of the agricultural sector is under private ownership, composed of close to 130 thousand small farmers whose property was guaranteed by the 1959 Law of Agrarian Reform. These farm units do not exceed 12.3 hectares or about 32 acres. Many of these producers have been grouped in Service and Credit Coops (CCS), where, in principle, they receive credit and other inputs in exchange for the contractual obligation to plant crops chosen by the government and to sell to the state (the Acopio), at prices dictated by it, no less than 80 percent of the production achieved. Acopio has become well known for late payments to producers for goods already surrendered and for corruption and inefficiency.

These ersatz coops are completely controlled by the government and do not follow the precepts of the International Cooperative Alliance (ICA), the international association of cooperative systems whose philosophy is based on the elements advanced by the 19th Century Roshdale cooperative pioneers. Its main principles, widely accepted throughout the world, are common ownership and democratic governance by members.

Other private farmers have been grouped under the Agricultural Production Coops (CPA), where they must follow contractual procedures similar to those in the CCS. In addition, these producers surrender their property, including their land, to the coop and cannot recoup it should they leave the coop. Like the CCS, CPAs also do not follow ICA coop precepts.

A third category, the Agricultural Production Basic Units (UBPCs), was created after the collapse of state farms. In this model, members do not even own the

land and are virtual employees of the state, on which they fully depend for financial and other services. Most UBPCs are subsidized by the State budget.

Outside of agriculture, it is illegal for individuals to create small or medium size enterprises. Existing ones are all state owned except for very few which are owned jointly by foreign investors and the State.

POST-SOVIET COLLAPSE REFORMS

In 1993–94, faced with a major economic crisis resulting from the collapse of the Soviet Union and the disappearance of large Soviet subsidies, the government undertook a series of economic measures designed to tap the entrepreneurship of individuals. Before that date, from 1968 to 1993, all forms of private enterprise and intermediation, save for the grandfathered small farms, were strictly prohibited. It is, furthermore, illegal throughout the economy for citizens to create and own small and medium size enterprises

The 1993–94 measures authorized the granting of self-employment licenses. More than 160 types of licenses could be granted. Categories were narrowly defined and specific geographic areas were assigned where the licensees could operate. They included trades such as plumbers and electricians. They also included categories such as cigarette lighter re-fillers, snow cone vendors, as well as bicycle taxis, clowns, etc. Initially, more than a quarter of a million licenses were requested and granted.

Individuals could also obtain licenses to rent rooms to foreigners in their houses, and to open small restaurants with no more than 12 chairs. In these restaurants, the state limited the types of food that could be sold. The government also reopened free agricultural markets, closed since 1985, where market forces would set product prices. Only farmers who had fulfilled their obligations to Acopio could sell in these markets. In addition, the new policy legalized both the holding of dollars by citizens, and the receipt of remittances from overseas.

Despite these changes, however, the Cuban government never changed its legislation prohibiting the establishment of Cuban owned SMEs. Furthermore, the government never organized a system under

which licensees could purchase the inputs necessary for their trades. The state dollar stores only partially served this purpose. This incredible, though well planned, omission led very quickly to a vigorous black market for inputs. These necessary but informal and illegal activities of the self-employed have made them vulnerable to government's police or to legal action against them.

Similarly, the government never provided access to the sources of credit that would be necessary to initiate or maintain self-employment activities, despite the existence of a state savings bank, the Banco Popular de Ahorro, and other state financial institutions. In most cases, the main source of start up capital and financing for many of the self-employed, particularly for the small restaurants and room-renting families, were the remittances of the Cuban exile community and whatever family savings existed.

The Cuban government was very candid about these changes. It saw them as highly undesirable though necessary because of the crisis. Stimulating individual autonomy and fostering self-reliance of individuals have never been goals of Cuban government policy.

Towards the end of the decade of the 1990s, as the economic situation stabilized somewhat, the government initiated a series of highly repressive procedures against the self-employed, including high taxes, continuous onerous inspections, and, ultimately, cancellation of a large number of categories under which individuals could obtain licenses.

Currently, the number of self-employed has diminished by more than half, to fewer than 120 thousand. It is doubtful that most of those who were denied licenses or whose licenses were later cancelled have disappeared. They are probably still operating in the informal or black market sector. In many cases, remittances probably remain a source of operational capital for these open or hidden economic actors.

Anecdotal evidence also suggests the demise of most small licensed restaurants because of harassment and economic repression. A vigorous campaign against those who have fixed their houses in order to rent rooms continues. The government now considers

them unfair competitors with state-owned tourist hotels.

Official dislike for remittances, this independent source of funds, is evident from leadership speeches and from attacks on their role and social impact. The government has recently imposed heavy taxes on exchange transactions involving foreign exchange. All foreign currencies must be exchanged for Cuban convertible pesos, or CUCs. The use of dollars in domestic transactions, legalized since 1993–94, is no longer permitted. The tax is close to 20 percent in the case of dollars, and 8 percent in the case of euros or other convertible currencies.

These changes have had the immediate effect of significantly reducing the net amounts received by recipients of remittances, while increasing resources going to the regime. The government has also warned that these taxes are likely to be increased in the near future.

A FINANCIAL SYSTEM TO SERVE UNDERSERVED GROUPS ONCE A TRANSITION PROCESS BEGINS

The large and swift response of individuals in taking advantage of the 1993–94 measures allowing a measure of private enterprise suggests that many in the Cuban population stand ready to establish successful micro and small enterprises. The issue of access to financial services is, however, one of the many serious problems—and not the most important one—that a future government will have to face at the start of transition. A more pressing issue will be what to do about the many existing layers of excessive central controls, legal and bureaucratic, that do not permit, and that, in fact, prohibit individual initiative and enterprise. This will be much easier said than done. The country will require new laws and policies, new systems to implement them, and a new legal framework to provide it with the proper frame of reference. No easy task:

- As an obvious essential first step, all legal impediments against private ownership by Cubans of production or service enterprises should be abolished.

- Second, there must be a legal system that protects private property, the sanctity of contracts, and investments.
- Third, all prices should be determined by the free play of supply and demand—the market.
- Fourth, all legal social, racial, and gender discrimination in the labor market and in education must end.
- And fifth, all state owned SMEs must be privatized, either by sales to employees or by public auction.

These policy changes would signal the beginning of meaningful reform and must be implemented rapidly, early in the transition. Once the policy and legal framework exists, and only then, access to financial services can have an impact on wealth, income, and employment creation. The new financial system will require a variety of institutional arrangements that can build on the values, the trust, and the local resources found in communities. Experience worldwide using a variety of approaches has shown their effectiveness in reaching tens of millions of poor people. In the case of Cuba, however, the transition government will have to deal with ingrained corruption and the so-called “doble moral.”

In fact, the transition government could use these institutions as well as the new commercial banks that will develop, as instruments to channel financial resources to entrepreneurs of all kinds. Such a program should be guided by market prices and under the same supervisory/performance rules applied to the financial system overall.

It is of enormous importance to undertake this institutional development effort in a broad and coordinated way. There is a need to establish a minimum number of institutions, a critical mass, to sustain the momentum of reform and to provide opportunities and hope to the population. As we have learned from other transition countries, the population needs to feel an impact in their own lives relatively quickly.

In the case of Cuba, for instance, one could use the existing network of CCSs as a foundation for a rural financial coop system. The cases of Romania and Poland offer some evidence that such a process could

work in Cuba. For instance, the financial quasi coop system called Comité de Ajutor Reciproco (CAR), that existed under communism in Romania, provided the foundation for a successful reform that has resulted in broad access to financial services provided by institutions, now owned and governed by members, morphed from the former flawed model.

THE ROLE OF FOREIGN AID

Many actors have helped fund and implement micro finance programs worldwide. External donors such as the International Fund for Agricultural Development, the World Bank, the Inter-American Development Bank, and the U.S. Agency for International Development have played an important role in supporting micro finance programs, with both technical resources and capital resources. Non-governmental organizations, both local and international, cooperative associations, private commercial banks, local communities and governments, have all been involved in these efforts. Groups such as FINCA (village banks), ACCION (solidarity lending), WOC-CU (financial cooperatives), Grameen (village banks plus business ventures), Shorebank, and City Bank

(commercial banks), and others are well known international implementers.

These different approaches can be integral part of the reform of Cuba's financial system. Again, they need to be subjected to the same financial regulations, quality controls, and external supervision as all financial institutions. Ultimately, the objective should be to have a seamless network of financial institutions that address the needs of individual clients. As a client's needs grow in size and complexity, she or he can smoothly move to the type of institution or approach that best serves his/her needs.

CONCLUDING REMARKS

Banco Sol and the Caja de los Andes in Bolivia; Mi Banco in Peru; the financial cooperative federations in Uruguay, Guatemala, Brazil, Poland, and Romania; the Grameen Bank in Bangladesh; the PKK in Indonesia; and Shorebank in Chicago, United States, are all part of the overall financial system in those countries. They provide successful examples that the task of creating financial institutions in Cuba, while daunting, is quite feasible.

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