A SYNOPSIS OF THE DUAL CURRENCY SYSTEM IN CUBA

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Abstract

In wake of Cuba's severe economic recession following the dissolution of the Soviet Union, the Castro government implemented a series of reforms to counteract hyperinflation of its Cuban peso (CUP) and regain monetary stability. The legalisation of the US dollar and subsequent creation of the Cuban Convertible peso (CUC) ultimately achieved those goals, but the prolonged simultaneous circulation of two different currencies for two different sectors has hindered potential economic growth and produced unfavourable economic effects and incentives. The resulting 'inverted social pyramid' implies that highly skilled state-salaried professionals such as physicians or university professors often earn far less than taxi drivers and tour guides paid while working in the tourist sector; the negative implications of such a structure are clear. If these issues are to be eliminated, the Convertible peso must gradually be phased out through further monetary policy initiatives on behalf of the current administration.

Keywords: dual-currency, Cuban monetary policy, Special Period reforms, Cuban Convertible peso

From an economist's perspective, the contemporary plight of the Cuban dual currency system offers a unique and intriguing case study in monetary policy. Throughout the past two decades, the Cuban people have normalised their daily lives within a system that requires the use of two different (albeit exchangeable) legal tenders for two distinct sectors of the economy. Such an abnormal situation provokes various formidable questions: Under what framework did the system come to be? What are the socioeconomic consequences, both positive and negative? How can such a potentially complex system be repaired, if not eliminated? Ultimately, what do the present conditions signify for the future of the Cuban government and its socialist agenda?

In order to understand the current circumstances, first it is necessary to examine the historical origins of the system, particularly the significant economic considerations. Following its peak in 1989, the Cuban economy entered its 'Special

Period', a famous euphemism coined by then-President Fidel Castro to encompass what would be the most severe and sweeping contraction in the country's history. The expedient collapse of the Soviet Union, in concert with the gradual intensification of the US policies surrounding Washington's long-standing economic embargo, signalled the commencement of a process of radical changes and crucial adaptations. Simultaneously, it became clear that the loss of participation, exchange, and near-complete integration amongst Marxist nations through the Council for Mutual Economic Assistance (Comecon) devastated the level of economic activity. According to one UN report, the socialist system accounted for more than 80 per cent of the total commerce for Cuba, including 70 per cent of manufacturing, 86 per cent of raw materials, and 98 per cent of combustibles (CIEM 2000: 30). That is to say, fundamental elements of the daily function of the industrial sector were lost almost in their entirety and completely without warning. The agroindustry also suffered tremendously; for instance, the value of sugar exports, traditionally the cornerstone of Cuban agriculture, decreased more than 82 per cent over the course of the first three years of the crisis (CEPAL 1997: 132). The volume of exports dropped more than 52 per cent during the same period. Thus, even the sectors that traditionally guaranteed a stable national income and economic stimulation contracted simultaneously and practically immediately. With relatively little diversification beyond these areas, the entire economy suffered.

As a result of all these destructive and interconnected elements, the Cuban economy experienced an immense paralysis; in the first four years of the recession, the gross domestic product shrank approximately 35 per cent in real terms while the deficit (as an average percentage of the national budget) hovered near 25 per cent (Perez-Lopez 1997: 10). To confront these enormous difficulties, the administration undertook a proactive approach to deal with the transition into economic independence. In terms of monetary policy, the government opted to liberalise foreign direct investment as a means to replace the losses of the 'sharp contraction of the financial security of Comecon, the drastic subsequent reduction of internal spending, and an adverse commercial setting' (Marquetti 2006: 6). Given the drastic losses, the economy could no longer focus exclusively on sugar production or industrialisation, the sectors that had sustained the country during the 25 years prior. The government proactively chose to assume the fiscal deficit by undertaking loans through the nation's Central Bank; as noted by Professor Pavel Vidal, a monetary policy expert at the University of Havana, such an undertaking was truly the only viable option to finance the growing deficit and counteract the slide because the Cuban financial system lacked any internal public market and sufficient access to the global financial sector (Vidal 2008b: 24). While the influx of new money subsidised the losses of the national debt, it accordingly created excessive levels of liquidity. The relentless augmentation of the deficit required printing more and more money, which in turn led to the inevitable consequence of hyperinflation – and the very root of the dual currency problem.

An implicit consequence of the government's action was the so-called 'inflation tax', a devaluation of currency assumed involuntarily by the collective body of citizens, workers, and their families. Although the purchasing power of each wage-earning individual diminished, the government chose this course intentionally so as to effectively 'administer' and distribute the negative consequences of the recession more evenly across various sectors of society in a way that the losses of the most affected sectors were essentially mollified. Hence, in spite of a severe lack of adequate finances, the administration achieved its intention of avoiding crippling widespread unemployment and maintaining social spending on education and health, the two cornerstones of the Castro Doctrine. While such vital national goals were not compromised, the intentional protection of these benefits clearly sacrificed the stability of the Cuban peso. That is to say, the value of the national money with respect to the dollar fell tremendously; during the worst stretch of the crisis in 1993, one Cuban peso equalled only one American cent, whereas it had purchased twenty times that amount in 1989. As a consequence of this depreciation, the dollar, which already served as the main legal tender of the illegal underground informal markets in Cuba, increased in circulation to the point that American legal tender became the preferred means of payment for non-state sponsored activities. The State, recognising the need to assuage the economic devastation and until that moment entirely lacking income from dollar-fed markets, decided to legalise the currency in 1993. Thus, the 'dollarisation' of the island had officially begun.

The exploitation of the dollar's position as the most trusted and fail-safe investment in the world provided an economic lifeline as the base level of stability during an extremely insecure and fragile period of adjustment. Within such a setting, prices remained adequately constant in a manner that would not have otherwise existed given the lack of confidence and credibility of the government's own currency. The obvious benefits of the incursion of foreign capital into the system included the proliferation of remittances (a majority percentage of which originated in the United States), an increase in tourism, and the facilitation of foreign investment into the business sector. Moreover, it eased the government into unprecedented reforms including the introduction of self-employment and small private agricultural markets. From the perspective of the administration, a greater level of internally stimulated economic activity facilitated the transfer of income from stronger sectors to social programmes. In this way, the legalisation of the greenback (and subsequent creation of the Cuban Convertible peso the following year) channelled a greater quantity of finances to the State, the largest national employer and good provider. The manoeuvre also contributed to the gradual accumulation of foreign reserves, a fundamental mechanism for monetary stability as well as a sound financial base for international trade.

The continued dual circulation of money effectively encouraged the concurrent development of two practically segmented economies. Given the difficulty in reconciling the goals and prices of state-run enterprises with those of independent institutions, the use of two monies has logistically eliminated the possibility of certain cross-currency economic interactions, let alone any form of extended cooperation. Equally notable from a socio-political perspective is the fact that certain segments of society (such as stores and hotels run with Convertible pesos), due to financial or legal limitations, generally do not permit the entrance or participation of Cuban citizens (the world-famous beaches of Varadero were a common point of contention); that is to say, the duality has exasperated the degree of inaccessibility for Cubans *within their own country*. Another significant issue involves the State's intentional fixing of the rate of exchange between the Cuban peso and the Convertible peso. While both currencies are indeed legal tender, the difference between the purchasing (25 pesos to 1 Convertible) and selling (24 pesos to 1 Convertible) at the Exchange Centres results in a loss of more than 4 per cent for any given exchange between the two – an unnecessary or, at the very least, excessive tax on the Cuban people that would not be levied within a unified currency setting.

More than anything, such segmentation has created unique (and in some cases, undesirable) social effects due to the 'inverted pyramid' created by salary discrepancies between the tourist and state economies. With large earnings gaps between state employees and workers within the tourist and foreign investment sectors, it is possible (and common) that extensively trained professionals (such as doctors, lawyers, and professors, among others) garner less than unskilled workers (such as taxi drivers, tour guides, and doormen). The true problem lies in that incentives to undertake some of society's most essential jobs clearly diminish while intellectual talent is attracted toward Convertible-paying sectors that do not make efficient use of their abilities. Furthermore, the inferior purchasing power of the Cuban peso also stimulated economic activity beyond the scope of what is considered 'legal' by the State, to such an extent that increased 'corruption' into black markets has become the most common means of obtaining certain goods and services otherwise inaccessible to state wage earners. The end result is that economic talent and energy are diverted toward secondary, non-essential activities at the expense of more vital, primary needs.

By the beginning of 2001, foreign currency constituted more than half of the total quantity of money in circulation in Cuba (CIEM 2000: 16); thus, in strictly mathematical terms, foreign fiscal and monetary activity clearly became a major influence on Cuba's own policy directives. Given the diminished significance of the peso at that time, it thus became an important political goal for the State to reclaim so-called 'monetary sovereignty' in both literal and psychological terms. For one, the proliferation of the American dollar signified an internal dependence upon the actions and political economy of the government of the United States, the foremost enemy and perpetual symbol of imperialism according to Communist Party officials. Thus, the 'de-dollarisation' of the Island became a necessary step in the process to purge any influence of Washington, with sights ultimately set on unifying the currency system. In this way, reforms undertaken by the Castro regime in the summer of 2003 to eliminate free circulation of the dollar (not by declaring it illegal, but instead by subjecting its use to a 10 per cent tax penalty along with other disincentives and resolutions realised by the Central Bank) serves as a testament to the effective use of Cuban monetary policy by the State and in turn spurs confidence in the implementation of future reforms. At the same time, however, the Convertible peso remains fixed to the dollar and thus still indirectly dependent on the whims and actions of the American Federal Reserve.

Within the Cuban academic community exists a general consensus that the government should eliminate the Convertible peso and ultimately return to the Cuban peso (and specifically not the other way around), given (1) its sentimental and national value, (2) the symbolism in restoring the solidarity and credibility in the money of 'the Cuban people', and (3) the potentially negative psychological and logistical impact upon Cuban peso wage-earners (for instance, earning 250 Cuban pesos each month is preferable to earning 10 Convertibles). Nonetheless, the manner in which monetary unification will be achieved remains another argument altogether. The State will need to implement a series of specific successive reforms to overcome certain inevitable complications that will impede an easy and immediate monetary transition. Although the value of the Cuban peso is fixed with respect to the value of the Cuban Convertible (24 to 1), and the Convertible peso is fixed with respect to the dollar (1 to 1.08), it is not conceivable to simply remove the intermediary and fix the peso to the dollar because of the discrepancy in exchange rates between business institutions and normal citizens. Specifically, the issue lies in that for commercial accounting purposes, the Cuban peso is equivalent to the Convertible at a rate of 1 to 1. This parity, instituted to facilitate government accounting and simplify national budgeting registrars, inevitably creates an obstacle to monetary unification because the process of reconciling the official exchange rates of the business sector with those of the public entails a complex time-consuming process requiring an ample and adequate period to adjust and reevaluate the structure of prices and budgets. Rectifying this overvaluation, then, must be the first component for change.

Should the government indeed opt for a gradual transition, it will need to reconcile the value of the two currencies to a single stable rate that truly reflects the market equilibrium and fulfils the fundamental economic principles of supply and demand. Using such a rate, the accounts, budgets, and prices of business enterprises can be converted accordingly to their equivalent values in Cuban pesos, a precursor which will eventually permit the same process of conversion for accounting and financial registrar activities at the national level. The universal adjustment of the values of money will have transcendental consequences with respect to the prices and quantities from international businesses; the devaluation of the Convertible would create previously non-existent incentives for both international and domestic enterprises, including the promotion of exports, a decline in imports, and increased competition amongst sectors of foreign investment, particularly tourism. By the same token, the development of long-term business partnerships will be key for the future development of the import-export sector. For example, under the symbolic principles outlined in Castro's famous 'Battle of Ideas' speech, the consolidation of close relations with Venezuela has provided a symbolic association for both nations built on an exchange of valuable Cuban services (doctors, professors, and other professionals) for subsidised petroleum and goods. Other leftist countries of Latin America (namely Argentina, Brazil, Ecuador, and Bolivia), China, and various Western European nations constitute important contemporary business partnerships and present huge potential for future economic prosperity in Cuba; a stable and credible currency will be crucial to maintaining these ties.

Although Cuba showed promisingly high rates of economic growth between 2004 and 2007 (as high as 12.5 per cent in 2006, comparable to that of China), the combination of three destructive hurricanes and the global financial crisis severely hindered agricultural returns and the tourist sector, respectively. In fact, the country lost more than a third of its total commercial trade in 2008. Moreover, recent spikes in the prices of petroleum and goods, combined with a diminishment in the value of nickel (an export which, in recent times, has been a critical stimulant to the Cuban economy), have retarded the influx of necessary capital for proper economic functioning. Due to this lack of income, it became necessary to fully take advantage of available financial resources from the primary sector, specifically amongst foreign investments. Inherent in the use of Convertible peso is 'the concentration of liquidity in determined social strata linked to emerging markets' (Casanova 2002: 50). That is, the depenalisation was a deliberate force intended to develop and maintain investment in the strongest sectors. During the crisis of the 1990s, the legalisation of the dollar served as a medium through which the government could monitor and tax the flow of funding so that the rest of the economy could share the benefits. However, one expert notes, 'the proliferation of impermeable divisions…impedes the most complete utilization of national resources' (Marquetti 2006: 9). Thus, while the dual money served effectively as a temporary transitional means of stabilising the economy and regaining control of the dollar, its protracted use still prevents full economic integration – a problem easily averted with a unified currency.

If seamlessly achieving a return to the Cuban peso seems difficult, altering public expectations about the process represents another challenge altogether. Unfortunately, the lack of popular discussion and debate about the issue of monetary policy has resulted in the proliferation of false perceptions related to the dual currencies, which in turn has failed to publicise the true reasons for Cuba's current economic deficiencies. The fact remains that seven years after the State's initial reforms to eliminate dependency upon the dollar, an equally vigorous dependency upon the Convertible peso persists. Within the Cuban community there exists an unfounded belief that once the Convertible peso is eliminated, most or all of the nation's economic problems at the personal and national level will disappear as well. The difficult reality is that this will not be the case. Reforms in monetary policy will not directly amplify the mean purchasing power because the deficiencies in that area are related to inefficiencies and weakness in worker productivity (Vidal 2008a: 25). Moreover, the public must come to understand that the change reached by monetary policy reforms will only be the first in a series of progressive steps toward economic improvement. There is an urgent need to implement a combination of innovative and potentially controversial policies, yet there still remain several valid concerns to be resolved prior to their realisation. For instance, the integrity of the socialist system is obviously a fundamental priority for the future development of the country, and the influence of foreign capital (and capitalism) along with the authorisation of highly regulated cases of self-employment and private property apparently present conflicts of interest between more accelerated economic growth and the progression of the socialist state. Yet two currencies effectively signify two classes; while such a situation does not necessarily contradict the ideals of socialism, it does inherently stand as an obstacle to the Party's ultimate goal of realising its final phase as a communist state. Hence, achieving monetary unification is only an initial, albeit essential step.

In spite of widespread apprehension toward reformist elements, a crucial realisation lies in that a greater level of business autonomy and the gradual progress of socialism are not mutually exclusive goals. Increased decentralisation (that is to say, a streamlining of bureaucracy and reduction of excessive regulation) can facilitate greater levels of efficiency and profitability without compromising socialist ideals. Furthermore, the use of innovative fiscal incentives, such as the sharing of business profits amongst employees instead of predetermined fixed salaries, can theoretically result in greater aggregate wealth for society at large, as the resulting increase in incentives and salaries of state workers would amplify consumption and output. As a result, the State would be able to use this additional generated wealth to better the quality of life for the most vulnerable citizens and families. With regards to the preservation of socialism, then, the most essential priority from the perspective of Cuban officials is to conserve ownership within the hands of the State and society as a whole; thus, the aforementioned economic innovations should not be seen as making the country more 'capitalist' per se, but instead improving economic productivity by applying characteristics of better businesses. While unification of the monetary system remains a pressing issue, evidence suggests that its implementation, although necessary, will neither solve all of the country's financial problems immediately nor eliminate the current inequalities entirely. Ultimately, improvements in efficiency and the development of methods and incentives for increased productivity at the business and institutional level will be critical in reaching the full economic potential of the country.

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