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During the last three decades of the Cold War, Cuba had one of the most collectivized, egalitarian, and subsidized economies within the Socialist Camp. The disintegration of the Soviet Union and its Eastern European allies in the early 1990s, resulted in a severe economic crisis for the island.¹ The magnitude of this external sector shock prompted the Cuban leadership to implement a series of structural reforms to confront the crisis, and to reinsert the country into the world economy, while preserving the socialist character of the Cuban revolution.² While Cuba embarked on a wide range of domestic and external sector reforms, reaching multiple sectors of the island's economy, one of the most notorious among these measures³ were the structural and organizational reforms implemented in the banking and financial sectors during the mid 1990s.

Given the scope and magnitude of these reforms, one fundamental question emerges: Did Cuba's banking sector 'reforms' constitute a legitimate effort to transform this sector of the economy, as the country embarked on a gradual process of economic transition? Or did they just represent a short-term measure to help the country overcome the difficulties of the "Special Period" and prolong the survival of the current regime?

To address this question, this paper provides a historical overview of the evolution of Cuba's banking sector during the Special Period, after the intro-

1. For a detailed analysis of the causes and effects of the economic crisis of the 1990s, see Mesa-Lago (2003).

2. Carranza, Gutierrez, and Monreal (1998) present a "Cuban perspective" on these measures.

3. Some of these reforms included opening the island's economy to foreign investment and tourism, legalizing the possession of U.S. dollars by ordinary Cuban citizens, reorganizing the agricultural sector, promoting some limited forms of self-employment, restructuring state-owned enterprises (SOEs), and repositioning the banking and financial sectors to facilitate domestic and international payments, and increase the size and scope of commercial transactions.

duction of Decree Law No. 172, and Decree Law No. 173 in May 1997. Following this presentation, the paper discusses the perspectives and implications of these reforms for the future, and presents several ideas and recommendations regarding the policy imperatives essential to further transform this vital sector of the Cuban economy once the process of the transition begins to take place.

The Evolution of Cuba's Banking Sector During the Special Period

Prior to the modest structural and institutional reforms initiated in 1995, Cuba's banking sector was comprised of a limited number of institutions, all with very specific functions, and product and service offerings. Among these were: the *Banco Nacional de Cuba* (BNC), which acted as the nation's central bank and bank of issue, the *Banco Popular de Ahorro* (BPA), which served as the island's only retail oriented depository institution, the *Banco Financiero, S.A.*, (BIFSA), which provided funding and financing for state-owned enterprises (SOEs) and their overseas affiliates and subsidiaries, and the *Banco Internacional de Comercio, S.A.*, (BICSA), which mainly functioned as a conduit to finance imports and exports (i.e., international trade). In addition to these institutions, the Cuban system counted with representative branches of two Dutch-owned and operated banks: ING Bank, N.V., and the Netherlands Caribbean Bank, N.V.

The efforts to restructure select sectors of the Cuban economy, resulting from the collapse of the so-called "Socialist Camp"⁴ in 1991, and the disintegration of the Soviet Union later in the same year, required the transformation of Cuba's banking sector in order to facilitate the country's reinsertion into the world economy.⁵ As a result, beginning in 1995, the Cuban leadership embarked on a series of gradual reform measures mostly designed to reposition and modernize the country's banking sector (Banco Central de Cuba [BCC], 2004).

4. The term "Socialist Camp" represents an informal, yet commonly accepted, reference to the Council for Mutual Economic Assistance (CMEA, or Comecon). The CMEA was established Jan. 25, 1949, by Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and the U.S.S.R. Albania joined in 1949, but withdrew in 1961. The German Democratic Republic (GDR), or East Germany, joined in 1950; Mongolia joined in 1962; and Cuba became a member in 1972. In 1978, membership was expanded to include Vietnam. It is worth noting that even though Yugoslavia had joined the CMEA since 1965, it mainly participated as an associate member. The principal objectives of the CMEA were to stimulate intra-member trade and exchange, to provide credit, and technical assistance and help members finance development projects. The CMEA was officially dissolved in 1991.

5. For a detailed account of the impact of the crisis on the Cuban economy and the outcomes of Cuba's policies to confront the crisis, see Ritter (2003).

The principal objectives of these reform measures were:

- To improve the technical and operational capabilities of national banking institutions through the automation of bank processes and procedures, information processing, and the retraining of bank management and personnel.
- To create a two-tiered banking system that would operate under the supervision of a newly chartered central bank (i.e., the Banco Central de Cuba – BCC) responsible for conducting monetary policy, and supervising and regulating the banking sector.
- To restructure the banking sector by authorizing the creation of dynamic and flexible institutions (i.e., banks and non-bank financial institutions) capable of better handling the diverse financing needs of individuals and state-owned enterprises (SOEs).

Modernization and Automation of the Banking System

Given the technological state of Cuba's banking sector in the mid 1990s, the first step in the reform process was the modernization of the banking system. This began with the automation of more than 500 branches and representative branches throughout the country, and the deployment of industry-wide computer networks beginning in 1995 (BCC, 2004). This process of modernization required the extensive training of more than 15,000 bank personnel and managers in the use of computer-based technology and sector-specific proprietary software (BCC, 2004). By 1998, the modernization and automation of Cuba's banking system was further extended by the implementation of an industry-wide connection effort carried out through the newly-developed *Red Pública de Transmisión de Datos* (RPTD, or Public Data Transmission Network) (BCC, 2004). The full implementation of this industry specific "intranet" facilitated the integration of the country's banking sector and sped up the transmission of data between main offices and their correspondent branches. Finally, by the end of 1998, all the Cuban banks involved in international transactions were directly connected to their foreign counter-parties through SWIFT,⁶ and several banks began to offer technologically advanced services such as automated teller machines (ATMs) and electronic account access cards (BCC, 2004).

Finally, it is worth noting that in an effort to reduce the costs of importing and obtaining the required components for effectively automating and modernizing Cuba's banking sector, a procurement strategy based on the following principles was implemented (BCC, 2004):

6. SWIFT is the industry-owned co-operative supplying secure, standardised messaging services and interface software to 7,650 financial institutions in over 200 countries. The SWIFT community includes banks, broker/dealers and investment managers, as well as their market infrastructures in payments, securities, treasury and trade. SWIFT provides several products and services, such as: electronic account matching and netting, secured electronic funds transfers, instant messaging, and transaction clearance and settlement. Source: http://www.swift.com/index.cfm?item_id=41322

- Acquisition of unassembled computer parts and components, so that final assembly could take place in Cuba, thereby reducing the final cost of the equipment
- Purchases were limited to quality name brands in order to use and deploy reliable and durable equipment and components
- Transportation costs were to be reduced by using sea transport as the primary means to import heavy technical equipment and components
- The replacement of parts and essential components was scheduled to take place at least every four years (or earlier)

Personnel Training and Development

Between 1997 and 1998, the *Centro Nacional de Superación Bancaria* (or the National Bank Training Center) offered a series of courses designed to train bank personnel and managers. According to official sources, more than 3,000 individuals participated in these courses or programs, out of which more than 1,000 were enrolled in graduate-level courses (BCC, 2004). The majority of the courses in this program were designed to train specialists in central bank policies and operations, and covered diverse topics such as: micro and macroeconomic policy, financial and business mathematics, monetary policy, bank supervision and management, financial statement analysis, and the roles and functions of the financial markets (in capitalist or market economies). In addition to these courses, and training program, technical and computer systems training was provided to key personnel and managers responsible for maintaining, supporting and managing information technology (IT) networks and systems.

Institutional Reforms and Newly Created Financial Institutions

The efforts to modernize and automate Cuba's banking system, and to retrain essential banking sector personnel and management, were complemented by the institutional restructuring of the banking sector, and the creation of a new central bank and several new financial institutions. The principal legislations dealing with these efforts were Decree-Law No. 172 (May, 1997), which outlines and defines the roles and responsibilities of the newly created central bank, the *Banco Central de Cuba* (BCC), and Decree-Law No. 173 (May, 1997), which specifies the rules and regulations pertaining to the creation, function, and supervision of depository institutions and non-bank financial intermediaries.

Decree-Law No. 172 (May, 1997)

Decree-Law No. 172 specifically outlines the functions of the Cuban central bank, the rules and regulations governing its functions and operations, and the intricacies of its organizational structure. The approval of this legislation by the Council of Ministers in May 1997, stemmed from the need to restruct-

ture and complement the functions of the *Banco Nacional de Cuba (BNC)*, which until the implementation of Decree-Law No. 172 had functioned as the island's central bank (BCC, 2004). With the approval of Decree-Law No. 172, the Cuban leadership initiated the first of a series of structural and institutional reforms aimed at restructuring the country's banking system to provide the necessary mechanisms to attract more foreign capital to various sectors of the economy.

The first chapter of this legislation outlines the general framework defining the roles and responsibilities of the new central bank (i.e., the *Banco Central de Cuba – BCC*). This is followed by a series of guidelines and regulations outlining the BCC's function as a bank of issue, its daily operations, its role as a fiscal agent for the State, the conduct of international operations, foreign exchange transactions, supervision and regulation of the financial system, and its overall organizational structure.

General Purposes and Functions of the *Banco Central de Cuba (BCC)*

According to Decree-Law No. 172, Chapter 1, the general purposes and functions of the BCC are (BCC, 2004):

- To function as the sole regulatory and supervisory institution for banks and non-depository financial intermediaries and institutions, operating in Cuban territory, national dependencies, free trade zones, and off shore locations.
- To contribute to the macroeconomic stability of the nation by ensuring, safeguarding, and promoting the soundness and stability of the banking system.
- To serve as the custodian and administration of the nation's foreign currency reserves.
- To authorize, regulate, and supervise the creation and operation of banks and non-bank financial intermediaries.
- To conduct the nation's monetary policy.

Bank of Issue

According to Chapter 2 of Decree-Law No. 172, the BCC is authorized to function as the nation's exclusive bank of issue. This means that the bank is the only institution with the legal authorization to issue or remit legal tender (i.e., paper currency and coins commonly accepted as a medium of exchange, a store of value, and a unit of account).

Bank Operations

Chapter 3 identifies the types of commercial (or business) operations in which the BCC can participate as part of its normal course of business. This section is broken down into five categories: (1) operations with (all types of) financial institutions, (2) fiscal agent for the State, (3) international operations, (4) foreign exchange operations, and (5) supervision and regulation of the financial system. According to Articles 16 and 17, in its dealings with

other financial institutions (both bank and non-bank) operating in Cuba, the BCC can provide loans, secured lines of credit, and short-term financing to institutions needing funding or facing temporary liquidity problems (BCC, 2004). In its functions as the sole regulator of credit and the circulation of money in the economy, the BCC is authorized to: provide loans (to member banks) drawn against required reserve deposits, offer discounted loans to depository institutions, buy and sell securities, real estate assets, and other financial and non-financial assets to influence the money supply, establish credit policies and regulations, regulate and oversee all types of financial transactions, and formulate and implement the rules and regulations governing acceptable practices and behavior in the financial system (BCC, 2004).

Articles 18 through 24, stipulate the functions that the BCC can perform as the sole fiscal agent for the State. Accordingly, the BCC is authorized to act as the official cashier (or payments agent) for the State, subject to the guidelines and stipulations established by the Ministry of Prices and Finance. This capacity allows the BCC to accept and remit payments, serve as a trustee or representative of the State, and perform all functions pertaining to its role as a fiscal agent (BCC, 2004). The BCC, however, is not allowed to issue new currency (or increase the money supply) to cover any deficits between the State's receipts and its obligations, unless authorized by the Council of State. Similarly, it is not permitted to buy (or sell) assets directly from (or to) the State (BCC, 2004). Finally, in its role as fiscal agent, the BCC is authorized to represent the State in any negotiations, conversions, or reappraisals of the nation's external debt. Acting in this capacity, the BCC is permitted to enter into legally binding agreements with the nation's creditors, as long as the Council of State authorizes such agreements or contracts (BCC, 2004).

In terms of international operations, Article 25 stipulates that the BCC can represent the State in negotiations with foreign creditors (in both the public and the private sectors), procure short-term and long-term financing or credit on behalf of the State, and buy and sell hard (or reserve) currencies (BCC, 2004). In addition, the BCC can extend credit to foreign central banks, and financial institutions, open accounts, maintain deposits, and conduct transactions on behalf of foreign banks and financial institutions, and administer the nation's foreign exchange reserves (BCC, 2004). In terms of foreign exchange operations, Article 26 requires the BCC to establish a foreign exchange mechanism (or system) that takes into account the nation's balance of payments and economic conditions, and maintain the official exchange rate system for the Cuban peso (BCC, 2004).

In addition to its "core" operations, the BCC is responsible for the creation, regulation, and supervision of all types of financial institutions operat-

ing in Cuba. As indicated in Articles 27 and 28, the BCC has the legal faculties to create (or establish) depository and non-depository institutions by the issuance of a corresponding license (BCC, 2004). It is also responsible for regulating and supervising all aspects of the employment of Cuban nationals by banks and non-bank financial institutions, and overseeing their operations in Cuba, as well as the operations of Cuban banks in offshore locations. On the domestic front, Article 29 indicates that the BCC is required to publish consolidated financial statements showing the financial conditions and operations of other financial institutions, prepare periodic research reports about the Cuban economy, conduct research and studies in the fields of banking and finance, and prepare and publish the nation's balance of payments report (BCC, 2004).

Decree – Law No. 173 (May, 1997)

Decree – Law No. 173 was approved with the objective of stimulating the development of Cuba's banking institutions and non-bank financial intermediaries, and to provide the legal and institutional framework to foster the creation of Cuban-based branches (i.e., subsidiaries and affiliates) of foreign banks interested in doing business in Cuba. In accordance with the provisions of Decree – Law No. 172, this legislation establishes and recognizes the BCC as the nation's central bank and sole supervisor and regulator of the financial system. In addition, Decree – Law No. 173, establishes the legal framework for the creation, regulation, supervision, and dissolution of new banks and non-bank financial intermediaries. In particular, this legislation deals with areas such as: (1) the creation of financial institutions, (2) the organization and function of financial institutions, (3) capital requirements, (4) business operations, (5) requirements and procedures for financial disclosure, (6) payments and compensation, (7) banking supervision, and (8) the voluntary or involuntary dissolution of banks and non-bank financial institutions.

One of the most visible results of Decree – Law No. 173 has been an increase in the number of financial institutions operating in Cuba and the scope of their operations. The following is a partial list of the most resilient of these newly created domestic institutions and their key functions, as well as the leading foreign financial institutions operating in Cuba.⁷

1. *Banco Nacional de Cuba (BNC)*

The BNC no longer serves as the central bank; instead, after the approval of Decree – Law No. 181, it performs the following functions:

- Commercial (business) lending in both domestic and foreign currencies
- Management and record keeping of the State's foreign debt

7. For a complete listing, go to: www.cubagob/cu/des_econ/banco/espanol/sistema_bancario/bcc/htm

- It also provides insurance-oriented products and services to entities and institutions engaged in the export-import business.

2. *Banco de Crédito y Comercio (BANDEC)*

BANDEC is authorized to function as a commercial bank, and it operates more than 200 branches throughout the island. The following is a list of highlights pertaining to the types of products and services that it offers:

- As of 2000, it had more than 55,000 “business” accounts, with balances denominated in both Cuban pesos and hard currencies.
- Most of its lending and financing activities center around the sugar sector.
- Its loan portfolio exceeded \$38 million USD as of late 1998.
- Out of an estimated 273,000 individual savings accounts, more than 12,000 were denominated in freely convertible currency.
- Some 47,000 accounts belong to small farmers and agricultural workers.
- BANDEC is also the leading provider of debit cards, offering automatic teller machines (ATMs) mostly in Havana, and other tourist centers (or polos turísticos).

3. *Banco Popular de Ahorro (BPA)*⁸

The BPA was chartered as a State-owned bank on May 18, 1983 through the approval of Decree – Law No. 69.

It has been authorized by the BCC to provide the following bank-related products and services:

- Accept deposits (in both Cuban pesos and USD)
- Offer savings accounts (in both Cuban pesos and USD)
- Extend short-term and long-term credit and financing to individuals and qualified “business” entities
- Participate in the sale, trade, and exchange of negotiable financial instruments
- Provide trust and custodial services, as well as administrative services
- The BPA has the largest network of branches in the island, with a presence in all 14 provinces through more than 270 branches.
- Its offices are equipped with personal computers and other related technologies needed to provide customers with real-time access to their accounts.
- The BPA offers customers direct access to their accounts via a network of ATMs and the issuance of electronic debit cards.
- The bank has an estimated 4.3 million accounts, out of which approximately 97% are peso-denominated savings accounts.
- It has a 25-percent ownership stake in the Netherlands Caribbean Bank, N.V., and had an active role in the creation of the *Corporación Financiera Habana, S.A.* in conjunction with Spain’s *Caja Madrid*.

8. For more information about the *Banco Popular de Ahorro (BPA)*, see: <http://www.bancopopulardeahorro.com/content.asp?show=131>

- As of December 31, 2003, its net income (in thousand pesos) was 47,896.5, which represents a 12.37 percent increase from the 42,622.6 reported by the end of 2002.
- By the end of December 2003, total assets (in thousand pesos) were 9,469,772, which represented an increase of 6.92 percent from the amount reported by the end of 2002 (which was 8,856,549).
- By the end of 2003, the bank had a total of 9,089 workers, out of which 1,365 were “executives,” 5,265 were classified as “technicians,” 559 worked as administrators, 1,474 were employed as “service employees,” and 426 were simply classified as “workers.”
- Of the total employees for 2003, 66.9 percent were women; and 39.8 percent were under 35 years of age.

4. **4. Banco Financiero Internacional, S.A. (BIFSA)**

BIFSA was created after the approval of Decree – Law No. 84 on October 13, 1984.4. Banco Financiero Internacional, S.A. (BIFSA)

It is authorized to provide the following products and services:

- Accept deposits in freely convertible currency
- Provide short-term and long-term credit financing and loans
- Transfer funds abroad
- Buy and sell precious metals, freely convertible currencies, and other transferable assets denominated in hard currencies
- Accept deposits denominated in hard currencies, and extend loans based on such deposits
- Issue letters of credits
- Act as a correspondent bank with national and foreign banks and non-bank financial intermediaries

5. ***Banco Metropolitano, S.A.***

Banco Metropolitano, S.A. began operations in 1997 as a regional bank (operating in Havana) to meet the banking needs of foreigners residing in Cuba. It was granted authorization by the BCC to provide the following:

- Individual accounts – denominated in Cuban pesos and freely convertible currencies
- Short-term and long-term deposits and certificates of deposits
- Travelers’ checks, credit cards, and electronic debit cards

6. ***Casas de Cambio, S.A. (CADECA)***

CADECA operates a wide-ranging network of foreign exchange “houses” throughout the island. CADECA was established in 1995 to provide the following:

- Foreign exchange services (i.e., buy and sell domestic and foreign currencies)
- Check processing

- Credit card services

Foreign Banks with Correspondent Branches in Cuba

- Havana International Bank Ltd.
- ING Barings
- National Bank of Canada
- Banco Bilbao Vizcaya
- Banco Sabadell
- Société Générale
- Argentaria, Caja Postal y Banco Hipotecario, S.A.
- Fransabank Sal
- Banco Nacional de Comercio Exterior SNC
- Caja de Ahorros y Monte de Piedad de Madrid

Foreign Non-Bank Financial Intermediaries with Representative Offices in Cuba

- Caribbean Finance Investments, Ltd.
- Fincomex Limited

Perspectives for the Future

The comprehensive (albeit gradual) series of reforms that have transformed the nature and structure of Cuba's banking sector since the mid 1990s, are part of an evolutionary and systematic process to re-adjust the Cuban economy to the "new realities" of the post-Soviet era, without the radical (or revolutionary) alterations (predicted by many experts and observers) of the State-centric nature of Cuban socialism. The creation of a new central bank (the *Banco Central de Cuba* – BCC) after the approval of Decree – Law No. 172 in May 1997, and the structural changes in the banking sector that took place after the approval of Decree – Law No. 173 in the same month, have gradually transformed this vital sector of the economy and have (hopefully) opened the door for further transformations once a comprehensive process of economic transition gets underway. While it is true that the institutional landscape in which Cuban depository and non-depository financial institutions, as well as their foreign counterparts doing business in Cuba, has been changed by the above-mentioned legislations, several unresolved issues and problems remain as obstacles to a truly revolutionary transformation of this key sector of the Cuban economy.⁹

First, the role of the State places a series of limitations and constraints on the functions of the banking system. For instance, because the central bank is

required to act as a fiscal agent for the State, there is no clear line of demarcation, which separates one from the other, significantly limiting the independence of the central bank (Echeverria, 1997). The use of artificial (i.e., non-market derived) interest rates and exchange rates further limits the ability of the central bank to act independently, since it must adhere by the policies set by the State, rather than those formulated by the market, when conducting monetary policy and standing ready to maintain an artificial exchange rate. In addition, the role of the State as the largest singular stakeholder in the central bank means that the central bank is obliged to extend loans, and honor the debts of the State, without having the flexibility to conduct adequate assessments of the risks associated with these practices. In essence, the central bank is required to extend credit to the State and honor its obligations without conducting the necessary analysis of its creditworthiness as a borrower. Finally, the central bank's role as the chief regulator of the banking and financial sector is limited by its dependence on the State; because the State retains the sole power to regulate and monitor the activities of the central bank, it is truly the State, not the central bank, who acts as the principal regulator of the banking and financial system (Echeverria, 1997). The main problem posed by this conflict resides in the fact that the majority of the customers in the banking and financial sectors, with the exception of individual depositors and borrowers, are State-owned enterprises (SOEs), and/or their partners and affiliates. Under these circumstances, it is quite plausible to conceive of a situation in which traditional lending criteria may be ignored given the legal relationship between the prospective borrower(s) and the State. This increases the risks associated with the loan portfolios of the central bank and the other institutions in the banking and financial system, and the probability of future banking crises.¹⁰

In the future, steps have to be taken to ensure the total separation of the State and the central bank, and divest the State from the banking and financial sector.¹¹ The proposed separation and divestiture, of course, should take place with the exception of some development banks or other similar institutions (e.g., community banks), which are vital to foster the development of certain economic sectors during the period of transition.¹² This will ensure a far

9. For a comprehensive list of suggestions for a desirable tax regime during the period of transition, based on the experience of other transition economies, which would complement the transformation of the banking sector, see Gallagher (1999).

10. Cartens, Hardy, and Pazarbasioglu (2004) provide a series of guidelines to help developing countries avoid banking crises.

11. Bentancourt (2004) provides a detailed account of the role of the State in advanced capitalist economies, developing economies, and economies in transition. His paper also provides a series of recommendations and guidelines regarding the role of the State in a future Cuban transition.

12. Gaynoso (2004) outlines the role and potential economic contributions of small and medium enterprises (SMEs), including credit cooperatives and development banks, in a future Cuban transition.

greater degree of independence and transparency for the central bank, and would facilitate the liberalization of interest rates and the exchange rate. In addition, these measures would transform Cuban lending practices so that the extension (or provision) of loans and credits more accurately reflects the risk characteristics and credit ratings of existing and potential customers. Comprehensive credit analysis, based on the analysis of financial statements prepared using sound accounting practices should become a fundamental aspect of the lending decision for all financial institutions. Finally, a great deal of work has to be done to improve the methods and practices used by the central bank to regulate the banking and financial system. The regulation of areas such as lending practices, disclosure requirements, product and service offerings, trading rules and procedures, among others, should fall under the jurisdiction of the central bank, along with specific regulatory institutions designed to oversee the business practices of non-bank financial intermediaries. The central bank and its newly created counterparts should stimulate the development of industry-based self-regulatory organizations (SROs) responsible for defining industry best practices and carrying out self-regulation. This would further enhance the independence of the central bank, as well as other newly created regulatory entities, while contributing to greater degrees of transparency and accountability, which would ultimately lead to increased investor confidence in the country's financial institutions.¹³

The second issue that emerges with respect to the current status of Cuba's banking and financial sector has to do with institutional redundancies and overlaps. There seems to be a significant overlap in the types of products and services offered by many banks and non-bank financial intermediaries. This points out to a relative lack of product and market differentiation among several institutions in the system, which, under different circumstances would more than likely result in consolidation via mergers and acquisitions (M&As) and/or hostile takeovers. However, the fact that there are several institutions in the Cuban banking and financial system with clearly visible overlaps in product and service offerings, as well as functions, and organizational structure, suggests that perhaps some of them may not be profitable, and only exist to meet the needs (either political or economical) of specific constituencies or "interest groups."

The third challenge confronting Cuba's banking and financial sector relates to the central bank's lack of access to the traditional tools necessary to successfully conduct monetary policy. Tools such as open market operations (i.e., the bank's ability to buy and sell government bonds in the open market

13. As Betancourt (2004) states, however, "one must ensure that the regulatory system is not used to prevent (market) entry. This is a common problem when regulatory agencies are captured by existing producers or when the rents from limiting entry accrue to those holding political power."

to affect the money supply), the use of a flexible discount window through which the central bank can influence the direction of interest rates, and control of a market-driven discount rate, seem to be absent from the Cuban system. The central bank, instead, maintains an artificial set of interest rates, which are channeled through depository institutions participating in the system. This means that rather than being market-determined (by the demand and supply of money or loanable funds); interest rates are artificially established by the central bank under the auspices of the State. In some cases, this means that borrowers that would otherwise be charged, “market rates” for credit and loans pay artificially low rates when using credit or loans to meet their financing needs. This, of course, reduces the profit potential of one of the most lucrative sources of income for commercial banks: the spread between the rates paid on deposits and the rates charged for loans (Fabozzi and Modigliani, 2003). In the future, artificial interest rates will have to be liberalized in order to maximize the profit potential of banks and non-bank financial institutions, and to stimulate the extension of credit, and consumer spending.

Finally, the potential of the banking and financial sector is limited by existing limitations on property rights and self-employment activities for ordinary Cubans. Limitations on the types of property that can be legally owned, transferred, and sold in the open market by ordinary Cubans, place artificial constraints on their ability to use personal property and assets as collateral to secure business and personal financing. Existing restrictions on self-employment activities, furthermore, limit the credit and financing demands of potential micro-entrepreneurs and privately-operated small and medium enterprises (SMEs) that would otherwise rely on credit financing, micro-financing, and collateralized loans to meet their businesses’ capital and funding needs, further reducing the potential profitability of the banking and financial sector. To address this major limitation, future reforms of the banking and financial sector should be complemented with a comprehensive program of reforms to address the need to establish property rights, grant ordinary Cubans with the opportunity to operate private business enterprises, and use their assets as collateral to secure various types of loans and financing.¹⁴

After more than a decade since the inception of the reform process described in this paper, the Cuban banking and financial sector still remains heavily controlled by the State. The creation of a new central bank, responsible for granting licenses authorizing the creation of new financial intermedi-

14. As Betancourt (2004) indicates, “a Cuban state that pretends to guide citizens through a democratic transition *must show its commitment to the protection of individual rights.*” Such commitment, he states, “is necessary for the development of markets essential for economic growth.”

aries, acting as a fiscal agent for the State, conducting and monitoring international operations and foreign exchange transactions, and responsible for the regulation and oversight of all depository and non-depository institutions, has facilitated the evolution and modernization of the Cuban banking and financial sector. This gradual process of evolution has been complemented by the creation of a series of financial intermediaries responsible for extending the scope of the financial products and services available to consumers, State-owned enterprises, and foreign firms doing business in Cuba.

However, despite the wide-ranging objectives of this reform program, the State continues to wield significant control over the banking and financial sector; there are notable institutional overlaps and redundancies; the central bank lacks full independence and access to the tools necessary to effectively conduct monetary policy; and limitations on property rights and self-employment opportunities severely limit the profit potential of this vital economic sector. Rather than signaling a revolutionary transformation of Cuba's banking sector during the Special Period, these recalcitrant reforms have simply constituted a gradual evolution from a Soviet-era system into a State-centric model of administration in which the State continues to play a significant controlling role as the sole administrator, proprietor, and regulator of the nation's banking and financial sector.

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