

Steps toward Access to Banking Services for Cuba's Non Governmental Sector

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INTRODUCTION

A central piece in the recent reform of the Cuban economic model is the opening to a small-scale nongovernmental sector: self-employed workers, private micro businesses and small farmers. In addition, a future expansion to include cooperatives has been announced beyond, the agricultural sector where it has always existed. This part of the reform is connected to another decision by which employment in the governmental sector is reduced by more than one million workers in order to increase productivity of state companies and make structures of the different ministries more efficient. Authorities plan that by 2015 more than 35% of the workforce will be employed in the private and cooperative sector.

The success of this strategy requires establishing different support systems from public policies, together with a growing liberalization of restrictions that have limited the development of private enterprise, and cooperatives within the Cuban economy. Recently, in November 2011, new steps were announced in this direction following new financial and loans regulations. The new legal framework was published in the Cuban Official Gazette number 40 of 2011, providing that the self-employed, micro enterprises and private agricultural producers may operate financially, along with other non-governmental entities that may be authorized hereinafter.¹ This new legal framework places them practically in equal conditions as to financial services and loans offered to state-owned companies.

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The new financial policy also opens doors to credit for consumer goods and the purchase of homes and cars in the household sector, although it has been specified that at this time, this will not be a priority. The opening

¹ See Ministry of Justice, *Gaceta Oficial de la República de Cuba* (Official Gazette of the Republic of Cuba) No 40, November 21, 2011, Havana.

Steps toward Access to Banking Services for Cuba's Non Governmental Sector

to a market of homes and used cars is another one of the transformations already in effect as part of the economic reform process. Financial authorities have indicated that the current credit priority for households will be the purchase of materials and the hiring of labor for repairs and construction of their homes.

SUMMARY OF BACKGROUND

The Cuban financial system consists of 8 state-controlled commercial banks, one mixed bank operating with Cuban and Venezuelan capital, 9 state-controlled nonbank financial institutions, representation offices of foreign financial institutions and state-controlled insurance companies. This is the result of the transformations of the system established in the nineties, among which was the creation, in 1997, of the Central Bank of Cuba, as a governing institution of the payment, financial and monetary systems and as a supervisory institution for banks.

Since that time the financial system has achieved certain progress in its modernization, automating information and developing of new services and instruments for attracting savings and granting loans. Commercial banks have enjoyed certain autonomy in the selection of customers, risk management and, in general, the authority to make credit decisions, always under certain general and political parameters defined by the Central Bank. The bank has remained in charge of the monetary activities, setting interest rates for bank loans, while narrow ranges have been set down for interest rates of loans.

One of the policies defined by the Central Bank has been to direct loans to the state entrepreneurial sector and agricultural cooperatives, among them, the Basic Cooperative Production Units (UBPCs) have had priority, but they belong to the type of cooperative that works with less autonomy.² Self-employed individuals have never had access to credit, and private agricultural producers have had very limited access.

The latest public information available reported that, in 2007, of the 9.46 billion Cuban pesos in credit granted by banks (394 million dollars at the current rate in money exchange houses of 24 Cuban pesos to 1 dollar), 68.4% was directed to state-owned companies; 23.2% to UBPCs; 4.7% to Agricultural Production Cooperatives (CPAs) and only 1.6% to independent private farmers or members of Credit and Service Cooperatives (CCS's). On the other hand, all the bank loans in convertible pesos has been directed to the entrepreneurial government sector and, to a lesser degree, to companies with mixed foreign capital. In 2007, credit in convertible pesos amounted to 1.719 billion (amount equivalent in US dollars, given the current exchange rate of 1 to 1).³

Loans to private households have also been very restricted. Most of the loans to individuals have been associated with national programs regulated by the government. For example, the so-called Energy Revolution in which high energy consumption electrical appliances were replaced, selling on credit other, more efficient appliances to consumers. Since 1998, individuals were allowed to go to banks to apply for loans for private purposes, but subsequently this policy was cancelled. These loans were granted only to workers of the government sector and retirees, with a maximum limit of 3,000 Cuban pesos (\$125 dollars at the current exchange rate in money exchange houses).

The financial restrictions on the private sector have not only applied to the issuance of loans, but also to the impossibility of using banking instruments and checking accounts. In most cases, banks require the handling

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² Some specialists do not consider UBPCs as a cooperative. For more details on the Cuban agricultural sector, see Armando Nova, "Agricultura" (Agriculture) in publication *Miradas a la Economía Cubana II*, 2010, Havana.

³ Data on credit are taken from Banco Central de Cuba (Central Bank of Cuba), *Informe Económico 2007* (2007 Economic Report), May 2008, Havana.

Steps toward Access to Banking Services for Cuba's Non Governmental Sector

of cash (bills and coins) as the main payment form. The private sector had been set apart from facilities that banks can offer. In addition, this raised a financial barrier that obstructed the relationship with the government sector, since the government works mainly with bank accounts and has to comply with strict regulations to make cash payments. Specifically, cash payment by state companies to a self-employed individual had been limited to 100 Cuban pesos (4 US dollars at the current rate in money exchange houses).

All previous restrictions answered to concepts that were the basis of the opening to the non governmental sector in the reform of the nineties, in which it was looked upon as a “necessary evil”; therefore, it involved keeping in an airtight compartment, without many possibilities of development or connections with the rest of the entrepreneurial sector. The new financial measures, however, point to a completely different direction.

LOANS TO PRIVATE AGRICULTURAL PRODUCERS

Before the publication in the Official Gazette in November, 2011, there had been an expansion of credit to private agricultural producers, due to the new process of delivery of lands in usufruct.⁴ Banco de Crédito y Comercio (BANDEC), with 203 branches throughout the country, has been the financial institution mainly in charge of expanding credit to private agricultural producers. In mid 2011 BANDEC reported that it had a portfolio of 13,000 agricultural producers. This portfolio grew 84% in 2010, compared to 2009. In March 2011 it had increased 11.3% in relation to December 2010. BANDEC reports that these volumes are not yet representative of the total bank financing portfolio, because they amount to only 3%. Some information provided by BANDEC in relation to credit policy for agricultural producers is summarized below:⁵

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- *Loan Purposes and Terms:* For working capital in the planting and harvesting period, with a term of up to 18 months. For livestock production (expenses for purchasing livestock and feeding it), payable between 18 and 42 months. For investments in necessary facilities and works for upkeep and utilization of land and development of permanent crops, also with a term of 18 months. The bank does not offer loans for clearing marabou⁶, but rather it provides credit based on a future viable crop.
- *Applying for and Follow-up of Loans:* Applying for credit may take between 7 and 21 days, depending on the amount requested. Before granting a loan, a visit is made to the farm, the land is appraised using agronomists and livestock engineers who support economists and financing officers of the different bank branches. In the course of a production cycle, random verification visits may be made to verify if the borrowed money is being used appropriately. If any irregularity is found, the credit may be suspended, restricted or demanded before its expiration.
- *Interest Rates:* The Central Bank decided that credits that are granted during the first two years of the usufruct to individual farmers will be subject to minimum interest rates within the range set by the Bank. For short-term credits (up to 360 days) it is currently 3%, if it is a credit for more than 360 days, then the minimum rate of the range set by the Central Bank is 5%. This type of loan has been established for individuals who begin exploiting the areas awarded.

⁴ Private agricultural producers (small farmers) may be owners of the land or usufructuaries. Some of them are members of the so-called Credit and Service Cooperatives (CCS's) for purposes of marketing, organization of common services and obtaining of credit terms, but without losing their autonomy as individual producers. For more details, see Armando Nova, “Agricultura” (Agriculture) in publication *Miradas a la Economía Cubana II*, 2010.

⁵ See interview with the President of BANDEC in *Juventud Rebelde*, “La Tierra tiene Crédito” (The Land has Credit), July 10, 2011, Havana.

⁶ Plant that covers most the land delivered.

Steps toward Access to Banking Services for Cuba's Non Governmental Sector

- *Guarantees:* The principal guarantee is the value of production that is going to be obtained and, in case of damages or losses, the indemnity paid by insurance company for the affected item. The producer must hold an insurance policy; thus, in case of any damage or loss, the insurance policy shall guarantee the repayment of the loan. In case of breach, BANDEC expresses that a renegotiation of the debt will be sought, that if it is not successful, it could be settled in court. BANDEC indicates that, up to now, there is a late-repayment rate of only 1% for this type of loans. Other guarantees that are undersigned in the new regulations are commented below.

THE NEW STEPS OF FINANCIAL POLICY

Starting December 20, 2011, three state Banks, Banco Metropolitano, BANDEC and Banco Popular de Ahorro, will be responsible for addressing the new financial credits and services. In addition to private agricultural producers, there are self-employed individuals, micro entrepreneurs and individuals who apply for loans to repair and to build their homes. The new financial regulations are also applicable to future non agricultural cooperatives, the potential expansion of credits to households for the purchase of consumable and durable goods, as well as, for credit and financial support to other forms of nongovernmental businesses that may be authorized in the future.

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Summarized below are some of the main elements of the new loan policy:⁷

- *Purposes, terms and amounts of credits:* Self-employed workers and owners of micro enterprises may apply for loans from a minimum amount of 3,000 Cuban pesos (125 dollars at the current exchange rate in money exchange houses) as working capital, with terms that do not exceed eighteen months, and for investments of up to 5 years. For private farmers, a minimum amount of 500 Cuban pesos is established (21 dollars at the current exchange rate in money exchange houses). For loans to purchase construction materials or payment for labor for construction activity, financing funds are granted from a minimum of 1,000 Cuban pesos (42 dollars at the current exchange rate in money exchange houses). If the loan is requested for the purchase of goods marketed in convertible pesos, the loan will be granted in Cuban pesos, applying the current rate in money exchange houses. There is no maximum limit for any type of loans. The amount and term of loans will be agreed between the parties according to the activity to be financed and proposed guarantees, within the parameters previously defined and setting down the lender's and borrower's commitments with the signature of an agreement.
- *Procedural Steps and Follow-up of Credit:* Applicants of the loans for investments or working capital must fill out a form specifying the feasibility of the business, estimated income, potential market, as well as guarantees. They must also present the license of the activity that they perform, their registration in the Taxpayers' Registry and the last receipt of payment of taxes (for those business that already exist). Credit Committees of each bank, at the branch and province level, and at main offices, have decision ranges depending on the amount requested. The loan is granted in several installments, not at once, so that the bank will be able to see, through visits to the place, that the funds are used for the agreed purpose. If there is any failure to comply with the date of agreed payments, a late-payment interest rate will be applied to the debtor on the amount of each unpaid term. In case of repeated breaches, the financial institution will adopt legal measures according to the guarantees defined in the loan agreement.

⁷ See Ministry of Justice, *Gaceta Oficial* (Official Gazette) No 40, November 2011 and interview with the President of the Central Bank of Cuba in *Granma*, "Por la Cuenta Corriente de la Actualización" (For the Updated Checking Account), November 25, 2011, Havana.

Steps toward Access to Banking Services for Cuba's Non Governmental Sector

- *Interest Rates:* Banco Central (The Central Bank) continues to establish minimum and maximum ranges of interest rates that banks will apply to these credits.⁸
- *Guarantees:* The following may be established as guarantees: a) Bank deposits of the applicant or of a third party, b) joint-liability bonds (legal commitment of a third party to pay the loan amount if the applicant cannot do so) in which case at least two guarantors will be required; these bonds may be issued by individuals, financial institutions or insurance companies, c) present or future personal repayments or income, d) bills of exchange or promissory notes backed up by a financial institution, e) personal property, f) mortgages of homes located in resort or summer vacation areas, as well as empty lots, and g) Credit and Services Cooperatives (CCS's) may act as guarantors for their members. All these guarantees may be subject to liens, precautionary measures or injunctions. Regulations establish that the following may *not* be offered as guarantees a) real property that constitutes a permanent home, b) personal property items of the debtor of indispensable use for the household, c) food pensions, d) land of private agricultural producers, e) social security pensions and f) capital assets of state-controlled companies and institutions with the exception of financial resources. In addition, it has been indicated that two thirds of salaries will be not subject to liens.

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Starting December 20, 2011, Banco Metropolitano, BANDEC and Banco Popular de Ahorro may also open checking accounts in Cuban pesos or convertible pesos for private agricultural producers, self-employed individuals and owners of micro enterprises (as well as other non-governmental forms that may be authorized in the future). Opening of a checking account becomes, in fact, mandatory for businesses with annual gross revenues of more than 50,000 Cuban pesos or equivalent amount in convertible pesos (2,083 U.S. dollars at the current exchange rate in money exchange houses).

Another new financial regulation provides that the entire non government sector can use, in addition to cash, the following payment instruments: a) bank transfer, b) check, c) bank draft, d) debit or credit card, e) local credit card, f) bill of exchange, g) promissory note and h) others used in banking practices.

CAPABILITIES AND CHALLENGES

It is difficult to assess the new measures before they have been enacted, without having information on the response of the non government sector and data on implementation by banks. Nevertheless, at first glance, some general features on capabilities and challenges can indeed be anticipated.

After the delivery of land in usufruct that started in 2008, the weight of the private agricultural producers (including those that are members of a CCS), within the total land that can be cultivated, has increased from 18.5% in 2007 to more than 35.3% in 2010, with high possibilities of doubling the record of 2007, once 2011 ends.⁹ Individual account holders and micro businesses also doubled the record prior to the opening of the economy in 2010.¹⁰ In the former case, there has been partial support, from banking institutions, specifically from BANDEC. However, in the latter case, expansion has occurred completely independent from formal banking. Having said that, one can assume that investments and working capital of new businesses have come from the savings of the actual self-employed individuals and micro businesses, remittances from abroad and resources that move through informal finances (loan from a relative, friend or other third parties).

⁸ On the date this article is written, ranges for interest rates for new loans were not yet known.

⁹ See National Office of Statistics, *Anuario Estadístico de Cuba 2010* (Statistical Annual of Cuba), Havana 2011.

¹⁰ At the time of writing the article, the last reported data was 146,816 land users and 333,206 account holders and micro businessmen. See newspaper *Granma*, November 25, 2011 and *Bohemia*, "Sin Pasión ni Prejuicio" (Without Passion or Prejudice), October 19, 2011.

Steps toward Access to Banking Services for Cuba's Non Governmental Sector

The current availability of financing from the three aforementioned state banks would, first allow adding new resources, making them available to private ventures. Secondly, banks would be more qualified to select projects of higher profitability and lower risk, with which efficiency would increase in the assignment of temporarily free resources in the economy. Thirdly, a proliferation of informal financing would be avoided, as it occurred in Latin America before the micro credit banking became available.¹¹ These three results would represent potential benefits of the new measures.

A foreseeable challenge is if these three banks whose experience and extensive knowledge has been formed under the premises of credits for medium and large companies, could quickly adopt the principles that govern microfinance.¹² Microloans require a specific system for their evaluation and follow-up, different from conventional banking standards. One alternative, more in tune with international practices, would have been to create banks or other financial microloans institutions, specialized only in serving said market segment. The creation of mixed capital microloan institutions (for example, with a Latin American micro lending institution) will multiply financial and logistic capabilities, and Cuban banking *know-how* when faced with the opening of a small-scale nongovernment sector.

Another immediate benefit would be the favorable impact that the news loans to households would have on the construction and repairs of their homes since that would help to partially alleviate the serious problem of housing in the island. From now on, and provided that the country's financial capability allows extending these credits to consumable goods and the purchase of homes, the potential of the domestic market as driver of economic growth will increase.

With respect to the possibility that the nongovernmental sector may open checking accounts and manage payment instruments that are used in banking practice, at first glance, we see the following positive effects. Their operating costs would decrease. Citizens could pay taxes, social security contributions, electricity, telephone, gas, water and other services through banks. The risk and the cost of managing and accumulating excessive amounts of cash would be reduced.

- Their connections with the government business and institutional sector would become financially viable and will promote the creation of relationships and value chains, also within the actual private and cooperative sector would be facilitated.¹³
- It would facilitate the control of legitimacy and it would especially contribute to reduce tax evasion. Control over payment of taxes would improve since businesses with gross income of more than 50,000 Cuban pesos would be forced to have a checking account. Businesses would have the incentive of depositing their income in said account, which could be used as a guarantee to apply for credit loans, among other benefits.

For the monetary policy, the access to banking services of the nongovernmental sector also has implications. It may lead to considerable changes in the demand for money, and in the most relevant measures of monetary aggregates that are used to understand and anticipate domestic demand movements. The new measures seem to make instantly obsolete the monetary policy that used the strategy to segment the population and

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11 Although to some degree, informal finances will always exist.

12 BANDEC, which is the one that has the most experience with agricultural producers, which has reached a maximum of 3% of its portfolio. See the publication *Juventud Rebelde*, July 10, 2011.

13 Another step in this direction was taken in the month of December 2011, when direct food sales were allowed from agricultural cooperatives and small agricultural members of the CCS's, to state-controlled restaurants and Hotels. See Ministry of Justice, *Gaceta Oficial de la República de Cuba* (Official Gazette of the Republic of Cuba) No 38, November 15, 2011, Havana.

Steps toward Access to Banking Services for Cuba's Non Governmental Sector

state-controlled companies, since they will become sectors more connected commercially and financially. Once credit expands to homes for consumption and purchase of houses, new financial transfer mechanisms will appear and the capacity of monetary policy will increase to influence short-term economic activity and to control inflation.¹⁴

Of course, new financial services also represent challenges for Cuban banks, which would seem to be already very close to their potential level in the performance of existing services that have also limited support for online banking alternatives, telebanking, magnetic cards and automatic tellers. In the nineties, the banking system made more progress in information and connectivity inward (between main officers of different banks, communications with branches and the Central Bank), but services to their customers still depend, to a large extent, on the physical presence at the teller's window, in spite of some progress achieved. Delay in the country's telecommunication infrastructure is one of the causes. Consequently, it is going to be difficult not to have bottlenecks in the supply of new financial services to the private sector.

This new access to banking for the nongovernmental sector requires a learning process, not just by financial institutions but also from the actual self-employed individuals, owners of micro businesses and agricultural producers, who will have to assimilate and become familiar with the use of bank credit, checking accounts and new payment instruments. In this process, the support from public policies will also be needed.¹⁵

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The banks and the non government sector will face another kind of challenge moving forward within the newly-established financial framework, and due to the actual economic setting in which they must function. Some of the most important challenges would be the duality of currencies and exchange rates, little access to a wholesale market of expendables, restrictions to importation, domestic financial crisis, limited convertibility of currencies, deficiencies in the incentive system in the state business sector, which would be among the most significant challenges. Nonetheless, at first glance, the new measures continue to look positive, therefore, they represent a signal of the actual acceptance of new players within the Cuban economic model, because of the favorable impact that they must have in their performance and because of the potential (and also challenges) of a more dynamic economic energized by banks and credits.



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¹⁴ For an explanation of the strategy followed in Cuba by monetary policy, see Pavel Vidal, "Política Monetaria en Cuba. Estimación con un Modelo VAR Estructural" (Monetary Policy in Cuba. Estimate with a Structural VAR Model) · *Revista Principios* (Publication "Principios") September 2008, Madrid.

¹⁵ Micro businesses with high revenues ("paladares" (small Cuban restaurants) for example) may hire personnel that have prior financial experience in state companies.