

Cuba's Financial System: evolution and challenges given the expansion of the private sector

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From 1959 until 1982 the monetary and financial systems were governed solely by the National Bank of Cuba (BNC), which concentrated the functions of central, commercial and investment banking, and handled all international financial transactions. This phenomenon could be explained by the limited role given to monetary-commercial relationships within the management of the economy, in sharp contrast with the expansion of the material and financial allocations which were extremely centralized in accordance with the economic planning.

Banco Popular de Ahorro (BPA) was created in 1983 to provide to individuals services such as savings accounts, and in 1984 Banco Financiero Internacional (BFI), was created to regulate international financial operations. Although these actions eliminated the monopoly of the BNC on financial transactions, and introduced certain degree of specialization, they did not allow a significant degree of development of the financial system.

Therefore, it was not until the middle of the 90s that the Cuban financial system was redesigned by the creation of the Banco Central de Cuba (BCC) and the restructuring of other banks and financial institutions, governed by decree Laws No. 172 and 173 of 1997. The new financial system was created at this time to respond to new needs and relationships established following the package of measures designed to cushion the effects of the fall of the socialist countries and the related loss of much of the commercial and financial relations in the island.

The banking and financial system established had two levels, and its governing body was the BCC, responsible for controlling and supervising the remaining financial institutions, as well as acting as fiscal agent of the State to ensure the good functioning of the collections and payments system, guarantee the stability of the purchasing power of the currency, and contribute to the economic balance and the orderly development of the economy.

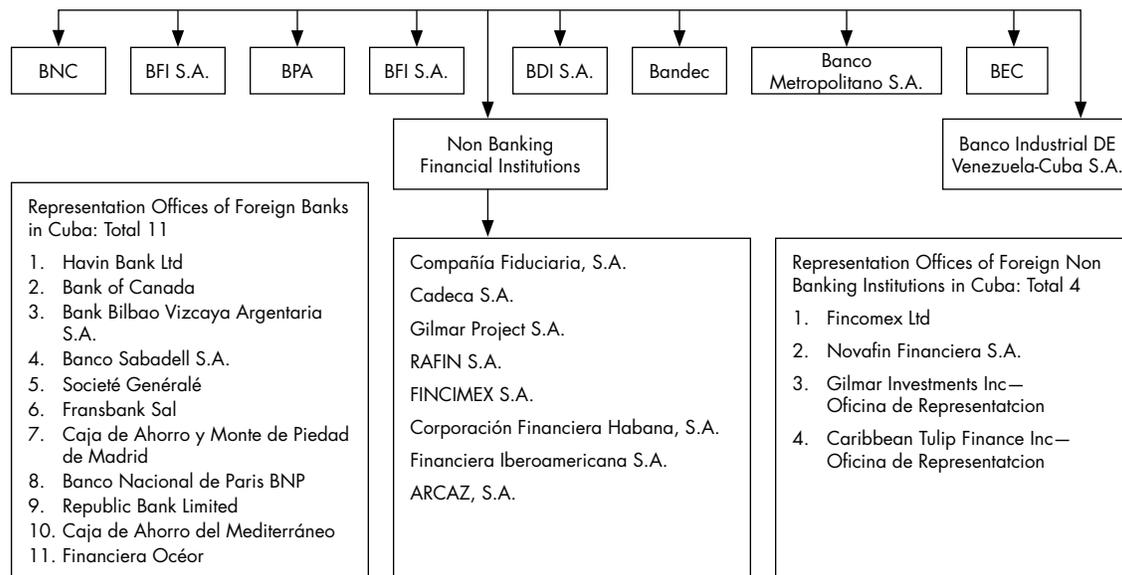
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To fulfill these functions the National Banking System consists of 9 Commercial Banks, 15 Non Banking Financial Institutions 11 representation offices of foreign banks in Cuba and 4 representation offices of non-banking financial institutions, led by the BCC (see Chart 1).

There is now a greater degree of specialization in each of the commercial banks in the financial system that takes into account the existing segmentation of the market, both by agents and by type of currency. Although all commercial banks have universal license to exercise all banking functions, in reality each bank has its specialization by type of operations: BFI, BICSA, BEC, BNC and BICV focus on managing financial relationships with foreign institutions, while banks operating within the national economy are BANDEC, BPA and BANMET. Of the latter group BANDEC has specialized in doing business with companies and with the agricultural sector, BPA with individuals, while Banco Metropolitano has a broader focus and works with legal institutions, as well as individuals, but only in the capital city. The Investment Bank, meanwhile, specializes in functions related to technical assistance, and it is the Bank that specializes in investments.

Chart 1: Structure of the Cuban Financial System.

Source: Banco Central de Cuba (2015)



Consequently, the Cuban financial system is practically limited by the framework of the banking network and a nonbanking financial institution dedicated to the currency exchange for the population (CADECA). Thus, the whole process of financial intermediation takes place mostly in a controlled manner within government institutions, with minimal use of the market. Both interest rates and exchange rates are dictated centrally, which limits the development of the functions of allocation and transfer of relevant resources for growth.

RETHINKING THE CREDIT POLICIES

Cuban credit policies have focused primarily on the financing business and agricultural cooperatives. In an attempt to support the changes arising from the adoption of the Guidelines for Economic and Social Policy a set of measures were approved related to the granting of loans to individuals in order to promote the expansion of the non-government sector and to some extent levels of consumption of the population.

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The first measures were incorporated into Decree Law 289 and Resolution 99 of Banco Central de Cuba in 2011. The first of these established general principles and procedures to regulate loans and other banking services for individuals, broadening the traditional spectrum to include independent workers (TCP), small farmers and other forms of non-government management (mainly nonagricultural cooperatives) and people needing to perform remodeling in their homes or consume material goods.¹

Meanwhile, BCC Resolution 99 authorized branches of BANMET, BANDEC and BPA, to process and fulfill requests for financing, and to provide new banking services to the non-government sector, highlighting the opening of banking accounts in Cuban or convertible currencies, and the possibility of using payment instruments such as bills of exchange, checks and others, non-existent up to this time. In 2013 these regulations were complemented by the expansion of the type of asset that could be offered as collateral, in an attempt to relax the mechanisms to access credit.

In order to foster the emergence and impact on the production structure of nonagricultural cooperatives, by the end of 2012 a fund of the State Budget was created. The main objective of this fund, managed by the authorized banks under the rules of BCC, is to facilitate the granting of soft loans to cooperatives which initially may not be creditworthy due to their original lack of capital. Therefore, this procedure marks a difference in terms of the support given to this form of production with regards to the private sector, for which the lending to initial capital² had not even been considered.

Despite the attempt to encourage the proliferation of new non-government financial forms, certain restrictions included in the new regulations minimize the possibility to promote the establishment of new enterprises, mainly for TCP, since not only collateral and guarantors are required, but in practice the applicant must have been involved in its activity for at least six months and must provide detailed information on the evolution of the business during this period, and a forecast for the period of repayment. These conditions restrict the lending to established operators, marginalizing those starting new business ventures, and leading to the use of endogenous sources of funding or the access to informal lenders. (Leon y Pajón, 2013)

The expansion of the credit has not produced the expected dynamic expansion of the non-government sector equally to all participants. The significant increase in the private sector, occurred initially without existing loans facilities, and once they appeared their impact seemed minimal. The limited number of loans granted to self-employed individuals, non-agricultural cooperatives and purchases of cooking equipment until October 2014 totaled 7,560³, completely out of proportion with the number of people currently working independently, which by the end of last year reached a record figure of over 476,000, and show that this policy is not attractive enough to capture that audience and effectively channeling financial resources.

Given the complexity associated with the loan application process, the urgency for funds that cannot be satisfied due to the lengthy application process and the perception of difficult access conditions, the demand for loans may be oriented to other informal sources from abroad, such as remittances or masked investments.

From the perspective of the banking system, the proliferation of behaviors associated with masked loans and investments constitutes a risk by stopping the receiving transactions and information associated with current

1 Beyond the consumptions of construction materials, the access to other goods and services through loans was included in the regulations under the condition that this operation would become effective once the economic conditions of the country allowed it. In fact, since this regulation was enacted in 2011 the only modification with regards to this issue has been the granting of loans to promote the purchase of cooking equipment for Cuban families.

2 At the closing of 2014 more than 73% of the approved cooperatives had requested this type of loans. (Piñero, 2014)

3 According to Marino Murillo during the meeting of the Ministers' Council in November 22014, published in the newspaper Granma, published in <http://www.ganma.cu/cuba/2014-11-30-/economia-cubnana-avizora-mayores-crecimientos-en-el-2015>

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ventures. While the authorities may consider tacitly that foreign savings can contribute to the revitalization of the nascent industry, the banking sector is then not allowed to play its role of channeling foreign savings, or placing internal savings in the investment process⁴.

The limited experience of banking institutions authorized for lending has meant to ignore the large movement towards non-government production forms that actually require a more differentiated credit policy based on creditworthiness. The current policy is extremely homogeneous and ignores the heterogeneity within the new sector (business size, contracting capacity, incumbents or new entrepreneurs, use of knowledge, etc.), showing the major differences in the treatment of various applicants in interest rates applied by the bank based on estimated risk levels.

In the immediate future, the credit policy should incorporate changes that include internationally validated practices that effectively attract different actors that currently interact in the Cuban non-government sector. Among the practices to assess, given the limited scope of many private businesses (given the limitations established for the sector⁵) and the relatively small requirements in terms of initial capital, are the usage of micro and overall microfinance. This would involve the creation of specialized institutions and evaluation of possible joint projects involving international organizations, under the aegis of the future regulatory framework that would effectively promote the generation of dynamic competition and increased production.

In this sense, it is evident that new initiatives have appeared abroad in order to promote business activities once the applicable Cuban legislation has been relaxed. Among these are the proposals made by the Cuba Study Group Microloan fund⁶ since 2006 and Fondo Empresarial Cubano⁷ in 2007, designed to offer support to Cubans by providing them the knowledge, resources and conditions to establish and operate small enterprises. Specifically, the first of the projects plans to work with Banco Compartimos S.A. of Mexico to establish a micro lending program for Cuba, with plans to “raise and finance” an initial capital of 10 million US dollars and to obtain additional funds that could be accessed from the different provinces in the country.

The second project attempts to obtain a total of 300 million US dollars to support small and medium size enterprises in Cuba and plans to offer Cuban businesses and financial institutions training, technical support and consulting. We must add that these proposals were developed more than a decade ago under very different context, which means that to put them into practice under today's reality, one would have to consider micro lending projects with significantly lower interest rates than the ones offered by Banco Compartimos in Mexico; and for the Fondo Empresarial the most viable option would be the creation of a fund financed by private entities, instead of government institutions.

All these initiatives took on greater significance after December 17, 2014 when the governments of Cuba and the United States announced their intention to initiate a process of “normalization” of relations. In this new context and facing a possible future lifting of the blockade, Cuba's biggest foray into international financial markets is inevitable, therefore opening a broad spectrum of possible public-private partnerships to promote and encourage the non-government sector partnerships in the Cuban economy.

4 In 2012, the frozen circulating cash in the bank in savings accounts from families represented approximately 25% of the PIB, which represents an important amount.

5 Must take into consideration the limited list of activities that may be exercised (approximately 200) and the narrow framework of activities.

6 See <http://www.cubastudygroup.org/index.cfm/start?=desatando-reformas-micro-economicas-en-cuba-invirtiendo-en-los-cubanos>.

7 See: <http://www.cubastudygroup.org/index.cfm/inicio?p=el-fondo-empresarial-cubano>.

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Moreover, the possible use of credit and debit cards⁸ for Americans visiting the island, also will encourage the channeling of financial resources more intensively towards investments in the non-government sector and private consumption. However, until the Cuban financial system decides to open up and give way to specialized institutions working with clients in this sector, any funding will be reduced to the channels of informality and will prevent brokering and allocation of resources in a more efficient manner.

Finally, the new measures that extended the granting of loans and other financial forms to the non-government sector represented an urgent element in the general framework of the transformation of the economic model. The short and medium term effects have shown to be very limited and the increase in the activities of the non-government engines have been promoted by other factors. Therefore, the measures needed to insert the Cuban banking institutions in the spaces to contribute to the growth, employment and productive diversification and therefore to the economic development are necessary and urgent.

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⁸ Mastercard and American Express announced the start of operations in the Island, days after the new measures of the Department of the Treasury towards Cuba were announced.

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