

## *The current deregulation of Cuban companies*

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**W**e cannot examine the last 50 years of Cuban economic activity without casting a critical eye. Even if we are clear about future goals, which are certainly full of challenges, an awareness of the pitfalls, errors, mistakes and misunderstandings from the past period may help to correct the future perspective.

Cuba is undergoing changes directed at achieving efficiency and increasing the productivity of the state-run enterprises (the plan), where efficiency depends, among other factors, on productivity. Productivity can be increased from different sources, but the important factor is that although a company may be proactive in the search for solutions, it is not possible to be proactive while being heavily regulated.

Various academic analyses show a decrease in the majority of state-owned economic sectors in the last 20 years, between the early 90's and 2010, as well as in virtually all sectors, with the exception of a few, such as telecommunications, mining and construction, sectors that have received a strong injection of foreign capital since the early 90's.

Another study on skilled labor force shows low motivation, due to unsatisfactory wages, few moral and material incentives, organizational problems, over-qualification and, of course, technical materials problems.<sup>1</sup>

In a rigorous study by economist Pavel Vidal on real and nominal wages, he highlights that in the past 24 years nominal wages kept growing, but the actual salaries fell sharply, since during the crisis of the early 90's prices increased between 8 and 10 times.<sup>2</sup> So the salary of a Cuban working for the state does not offer motivation to increase labor productivity.

1 Cribeiro, Y: *"Contribución de la fuerza de trabajo calificada al crecimiento económico en Cuba. Principales determinantes"*, PH thesis, November 2011, Annex 3,7.

2 Vidal, P: *"La política monetaria cubana frente a los mecanismos de transmisión de la crisis"*, Seminary of the CEEC, La Habana, June 2010.

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Another Cuban economist, Ileana Diaz, in an interesting study suggests the following:

- The regulatory framework of Cuban companies, does not encourage employees to be more efficient and effective. Why, if the regulations control even the smallest details?
- A Cuban business owner cannot use his own resources to solve his company's problems and must wait for the government to assign him the needed resources. This is conducive to discipline, instead of creativity, and it teaches to react to problems, instead of being proactive.
- The plan is defined only in terms of restrictions and not so as to stimulate demand.
- Existing regulations increase transactional costs or lead to the creation of vertical structures at the work place (as a way to compensate for the inefficiency of others), which results in increased costs.<sup>3</sup>

State businesses are fully aware of their internal resources and weaknesses, and the fact that they have inflated payrolls or excess workers, and that there is limited capital assigned to the work performed, and a high level of technological obsolescence and material consumption. But they are also aware they lack leeway in order to try to minimize these negative factors, because among other things, a company needs to manage financial resources, a decision that in Cuba is reserved to the high levels, due to the excessive centralization of economic decisions.

Producing entities operate under a rigid structure, both structurally and economically, which leads to prioritizing discipline and compliance with plans or tasks, over promoting autonomy and independence that encourages individual creativity from the workers, which requires above all, time. Their organizational structure is hierarchical-functional, fully centralized and vertical in application, and generally uses autocratic management methods.<sup>4</sup> Consequently Cuban managers act in response to an overwhelming regulatory framework.

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The government plan, an important part of the regulatory framework, adopts a style that confuses discipline with rigidity, which means that everything should come from the plan. The plan ceases to be the facilitator, communicating vessel of the economy, to become the obstacle and a discouragement to business performance.

Production volumes are not decided at the corporate level, since in the majority of cases, these are dependent on imported or domestic inputs (which depend in turn on imported assets). With the existing financial restrictions, the introduction is a category defined at the highest level. Also the companies may not be able to receive micro investments that may, in some cases, increase production, even in the case of exportable products.

In a study conducted by the commission to implement the economic and social guidelines, of more than 2,697 state enterprises, covering 44% of employed workers, it concluded that many state-owned companies had losses, and the subsidies for losses in 2011 exceeded 1,500 million pesos, and also that 70% of the profits were grouped in only 4% of companies in the country.

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<sup>3</sup> Diaz, Ileana. "La eficiencia en la empresa estatal cubana". IPS. Thursday, April 11, 2013.

<sup>4</sup> *Idem*

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The main findings of this study were:

1. Norms and regulations applicable to companies are excessively administrative and bureaucratic.
2. Macroeconomic policies do not support Cuban companies.
3. There are limitations for the release of their potential.

Therefore, the decision adopted by the group's business improvement area was to "take the necessary steps required to change"

### **DEREGULATION OF THE COMPANY**

This situation led to the decision to try business experiments in more than 100 companies in 2013, eliminating some of the obstacles described above, gradually applying new operating principles, rescuing concepts such as selected production or government orders, placing temporarily available funds in financial products, approving the sale of tangible fixed assets, withholding depreciation within the company, among others.

In line with the need to mitigate and change the regulatory environment, it was decided to undertake an institutional restructuring (merger of ministries and branches creating Superior Business Management Organizations (OSDE), and to transfer business functions of the ministries. The bulk of state enterprises should be grouped between 25 and 30 OSDE.

Another past obstacle to overcome, was the adoption of policies to expand social objectives of businesses, which forced them to produce only what they were authorized to produce.

On July 2013, at the National Assembly of People's Power, the new deregulation elements to be applied to Cuban companies in 2014 were explained.

Examples of deregulation:

- Companies can sell idle or slow-moving inventory to any form of property.
- Depreciation and amortization of tangible fixed assets and intangible assets shall not be paid to the state budget.
- Companies shall contribute to the state at least 50% of profits to be distributed as a return on state investment.
- After covering the state contribution, the remaining amount can be used to increase salary payments, investments, training, research, increasing working capital, repay loans, etc.
- Approve increase of imports to comply with exports.
- Social objectives are relaxed, and based on a government order, the rest of the production can be processed and sold.

Of course these are not the only changes needed by Cuban companies to begin on a path of sustainability, growth, and quality of its products, but they offer a different perspective from that of the past.

Another bold step, although slow and insufficient, is the authorization of urban cooperatives, so called to differentiate them from farm cooperatives, which throughout the previous period did not achieve the success that was expected of them.

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The goal is for the government to withdraw from matters that are not essential in the development of the economy and that it is almost impossible to keep under its control. Under the first decision 124 cooperatives were approved. Of this group, 112 are from the government sector and 12 from the private sector.

- Ninety-nine are farm markets located in the new provinces of Artemisa, Mayabeque and Habana.
- Two of these are dedicated to raw materials and recycling
- Twelve are related to the construction business, and one of them is in the business of refrigeration equipment.
- Six are dedicated to transportation support businesses, such as automobile bodywork, paint, upholstery, road tow truck services, car wash and repair of flat tires.
- Five are in the area of transportation of passengers, 2 of taxis, 1 school transportation and 2 in small buses in Artemisa and Mayabeque.

Seventy-one cooperatives were approved in a Second Group, including:

- Twenty-two commerce, gastronomy and services cooperatives.
- Sixteen small industries cooperatives.
- Twelve in the area of construction.
- Two in the area of food production.
- Two in the area of transportation.
- Seventeen related to ornithology.

*...more cooperatives are needed in the area of industrial production, construction, etc. in order to allow the increased production demanded by the population...*

In general, more cooperatives are needed in the areas of industrial production, construction, etc. in order to allow the increased production demanded by the population, and the economic growth of the country as a whole.

Along with the deregulation being implemented, and given that it affects all forms of production, but especially private and cooperative forms, the government has begun a reorganization of wholesalers.

The diagnostic prepared to support the need for changes in the wholesale business is the following: <sup>5</sup>

1. The market has been undersupplied.
2. There are high levels of idle inventories in a number of entities.
3. There is no timely re-provisioning to guarantee a stable supply of products.
4. Unnecessary investments are made without taking into consideration the country's infrastructure.
5. The commercial operations are ignorant of the market conditions and fail to provide adequate customer service.
6. There are many prices for the same product, even, in some cases, when they come from the same supplier.
7. Lack of follow-up and continuity to the provision of parts and accessories of imported equipment.
8. Given new commercial scenarios, the transformation of the wholesale market is vital.

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<sup>5</sup> Cubadebate. "Pasos en el reordenamiento del comercio mayorista en Cuba" August 1, 2013.

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In an attempt to solve elements described in the diagnostic, resolution 242/2013 from the Ministry of Commerce was approved, to implement a policy for the wholesale market which among others, establishes the following elements:

1. The wholesale market should be conducted by legally authorized individuals and companies.
2. A list of wholesale entities is prepared, incorporating the Steel Industry Group (ACINOX) from the Ministry of Industries, as domestic distributor specializing in metals. Also included is the Equipment and Parts Division (DIVEP) from the Ministry of Industries, in the distribution of goods destined to support industries.
3. Business Group PALCO from the Council of Ministers is included and will meet requests from the diplomatic sector and all those individuals and entities that are authorized to receive such services.
4. Wholesale businesses should guarantee the supply of products on the basis of a diversified portfolio comprised of suppliers, producers and distributors.
5. Wholesale companies shall consider as first choice all domestic production, provided they are competitive in quality, price and opportunity, something that will be regulated by harmonizing with demand.
6. The wholesale trading companies shall plan and will specify in contracts with suppliers the necessary supplies to prevent gaps in replenishment cycles to their customers.
7. Wholesale companies may buy at prices agreed to by domestic producers, agricultural producers (Agricultural Production Cooperatives, Credit and Service Cooperative, Basic Units of Cooperative Production and State Farms), companies that are included in the experiment, and others approved, after they have fulfilled government requirements contained in the Plan, the surplus production and services resulting from contractual breach.
8. Entities that currently supply or provide services to economic activities that now operate as cooperatives, shall continue to supply such services according to the commercial policies and without subsidies. This is the case of the transportation service cooperatives, who must acquire the necessary inputs such as fuel, tires, parts and others. Currently work is being done on what is called wholesale money market, seeking a multiplier formulation 1 CUC X 10 CUP, rather than the one applied to the population of 1 CUC X 25 CUP, in order not to increase the price to the public of 5.00 pesos on buses routes.
9. Wholesale firms may sell supplies and other approved products to agricultural entities and cooperatives, based on the approved nomenclature. The sale will take place at retail prices, without subsidies, less commercial discount, in stores approved by the appropriate distribution channels.

*It would be extremely beneficial to approve the presence of foreign business entities in wholesale markets...*

Currently, the self-employed obtain their supplies in the retail market in CUC and CUP, therefore, it is important to take this into account in the process of reformulation of the wholesale businesses, starting on 2014.

It would be extremely beneficial to approve the presence of foreign business entities in wholesale markets, consignments, franchises and other forms of marketing, as they could contribute to offset the shortages still existing in the market.

Much hope is placed on the 2014 plan, and it should be noted that the economic plan clearly identifies the required contribution by companies to the government, which is said will ensure indispensable financial and

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material resources. The framework for government entities and their purchase capacity has been eliminated by 2014, which represents an important path to independent financial management.

On January 29, 2012, at the closing of the First National Conference of the Communist Party, Raul Castro stated that:

*“The only thing that can lead to the defeat of the revolution and socialism in Cuba would be our inability to eradicate the mistakes made in the 50 years since January 1, 1959 and those that we incur in the future.”*

Following this thinking, it is clear that the challenges posed by the transformation at a relatively short term of the existing structural distortions in the Cuban economy. If we want Cuba to become a land of opportunities and to achieve a sustained increase in the standard of living for all Cubans, then the time to make such decisions is not very far away, and the measures to take must be more pragmatic than those taken under the current government. At the same time we cannot forget to take into consideration the harassment that Cuba is subject to in its external transactions by the U.S. government.



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