Cuba’s hidden tax on workers mocks socialist ideals

By Barry Wood
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HAVANA, Cuba (MarketWatch) — American visitors arriving in Cuba should be aware that the communist island has two currencies of widely divergent values circulating simultaneously. The more brightly colored convertible peso (CUC) is exchanged at 1 to 1 with the U.S. dollar.

However, most Cubans live with the lowly national peso (CUP) that trades at 24 to the CUC. An average monthly wage is CUP 480 or $20.

The CUC was created in 1993 when the Cuban economy was in deep crisis from the sudden loss of subsidies from Russia. Desperate for foreign currency, the Cubans sought to capture the foreign exchange that tourists were spending by forcing them to buy pesos at an inflated price. They’ve been stuck with two currencies ever since. Visitors will notice that prices are listed in CUCs and CUPs.

Cuba’s foreign-managed hotels are a case study of how unfair the system is. Tourists pay dollars to the hotels, which then set aside in CUCs (1:1 to the dollar) the wages owed to employees. That money goes to the state employment agency that actually pays the workers.

Now the catch. The state entity pays the workers in CUPs and pockets the difference, which goes to the government. With a 2,000% disparity between the currencies, the windfall is huge. A worker typically gets only 480 CUPs ($20) from the 480 CUCs ($480) the hotel set aside for his/her salary. This indirect tax nets the government $460. On every transaction.

Augusto de la Torre, the World Bank’s chief economist for Latin America, calls this practice a huge tax on labor that is offensive to socialist ideals. De la Torre, a former central bank chief in Ecuador, has co-authored a paper on how Cuba can unify its two exchange rates.

Aware that the dual money system is unfair and inefficient, the Cuban authorities have said for years that they're going to change it and have just one currency. But unifying them is a complicated task and, not surprisingly, they don't know how to do it.

Anders Aslund, a researcher at Washington's Peterson Institute for International Economics which hosted a recent forum on the Cuban economy, says unless the currency transition is done skillfully there could a run on the banks and runaway inflation. He emphasizes that no one knows what the actual peso-dollar exchange rate should be. Cuba is broke and thus has no hard -currency reserves to back up whatever exchange rate is eventually fixed.

The partial normalization of Cuban-U.S. relations is likely to mean that hotel maids, waiters and cab drivers will see their incomes rise because American travelers tend to leave generous gratuities. This, says John Kavulich of the U.S. Cuba Trade and Economic Council, will widen income inequality in the communist state.

Sen. Jeff Flake, the Arizona Republican who is a strong advocate of normalization and a frequent visitor to Cuba, says the Raul Castro government faces huge economic challenges. Noting the absence of modern cars on the island, Flake joked at the Cato Institute this month, that "the Cuban regime is traveling the last mile to communism in a 1957 Chevrolet."

This month the Cuban authorities began issuing high-denomination CUP notes, saying the move is preparation for the long-delayed currency unification. The central bank said it expects CUPs to be more widely used and thus 200, 500 and 1,000 CUP notes are needed. Monetary experts say the move probably suggests that the Cuban authorities are expecting a big uptick in inflation.

Cuba may be considering applying for membership in the International Monetary Fund, a potential source of money and equally important technical advice. Cuba was a founding member of the financial cooperative but after refusing to pay its foreign debt the Castro government withdrew in 1964.

Some years earlier the Argentine-born revolutionary icon Che Guevara headed the Cuban central bank. His image adorns the tattered three-peso CUP, but he's not present on the much more valuable three-peso CUC.