Decoding Cuba's Currency Reforms

Why in news?

Cuba unified the Cuban peso (CUP) and the Cuban convertible peso (CUC) as one currency, and put an end to the decades-old dual currency system effective January 1, 2021.

How does Cuba's monetary system work?

- For nearly three decades, two currencies have circulated in Cuba - the peso (CUP) and the convertible peso (CUC).
- Both were officially valued at one-to-one with the dollar.
- Neither currency is tradable outside the country.
- The currencies are exchanged at various rates:
    i. one-to-one for state-owned businesses
    ii. 24 pesos for 1 CUC for the public and others for joint ventures, wages in the island's special development zone and transactions between farmers and hotels
- Cuba created the system as part of a package of measures to open up its economy after the collapse of the Soviet Union.
- While the system helped Cuba get through the shock of the Soviet collapse, it also ended up hiding the real economic situation.

What is the change made now?

- Cuba went with devaluation of the Cuban peso (CUP) and the withdrawal of the convertible peso (CUC). The CUC will be eliminated.
    - The CUP is in circulation in the domestic economy and serves as the principal medium by which goods are priced and wages paid.
- President Miguel Diaz-Canel said the devaluation would leave the peso at a single fixed rate of 24 to the dollar.
- The government has also begun opening stores that sell consumer goods for dollars and other traded currencies, though only with a bank card.
- This is a temporary measure but the partial dollarization will also provide some stability, especially for families who receive remittances.
- Meanwhile, state and private companies can now keep tradable currency accounts with up to 80% of their export earnings instead of handing them over to the state.

How did dual domestic currency come about?

- During the turmoil in Cuba's sugar industry and a plunge in nickel prices in the 1990s, a volatile CUP had fallen to 140 to the dollar.
- Against this backdrop, the CUC was introduced in 1994 as a unit of account and store of value.
- The objective was to prevent the country's excessive reliance on the U.S. dollar following the end of the former Soviet Union.

What is the rationale for the reforms now?

- The reforms aim to eliminate price distortions arising from multiple exchange rates and reduce Cuba's dependence on imports of basic commodities.
- These conditions have been exacerbated by -
    i. the fallout from the COVID-19 pandemic
    ii. decline in the export of the nation's famed medical services
    iii. the depletion of foreign exchange revenues from tourism
    iv. the crippling impact of U.S. economic sanctions
- In recent years, the second currency [CUC] has more or less steadied at one CUC to 24 CUPs in official exchange outlets.
- It is the predominant mode of transaction for tourists and residents at high-end shopping outlets and other imported goods.
- There are disparities attributed to the prevalence of a dual domestic currency.
- The recent shift is part of the government's bid to boost dollar transactions alongside other hard currencies.
- It came especially after tourism was closed in the wake of the pandemic.

What is the significance?

- Cuba's switch back to a single currency was an important objective in the economic transformation plan envisioned in the 2011 Congress of the Communist Party of Cuba under former President Raul Castro.
- Among the expected gains from a unified peso are -
    - transparency of firms in terms of costs and profits
    - higher economic productivity and incentives for exports
- Experts have opined that a corresponding devaluation of the peso was a necessary first step to discontinue the dual currency.
    - The government has sought to balance the likely impact of high inflation resulting from the devaluation with a generous wage and pension hike for state employees.

- A roll-back of subsidies to state-owned firms is also proposed.

What are the challenges?

- There is concern that the circulation of hard money could reinforce the segmentation and distortions of the past that resulted from access to the CUC for public sector companies at preferential exchange rates.
- There are also concerns that the devaluation could still leave a sizeable private and informal sector labour force exposed.
- There is also the risk with adverse effects from high prices.
- Amidst this, it is essential now that Havana takes citizens along in order to implement the new reforms.

Source: Reuters, The Hindu

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