

JORGE F. PÉREZ-LÓPEZ

CUBA'S

SECOND

ECONOMY

FROM BEHIND THE SCENES TO CENTER STAGE

Cuba's Second Economy



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Contents

<i>Introduction</i>	1
1. The Second Economy: Concepts and Measurement	7
2. Cuba's First Economy	33
3. Cuba's Second Economy	77
4. The Cuban Economy in Crisis	119
5. The Second Economy and the Market Transition	153
<i>Glossary</i>	185
<i>Bibliography</i>	191
<i>Index</i>	217



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Tables and Figures

Second Economy: Concepts and Measurement

Figure 1.1	Interactions between First and Second Economies: Control versus Legality	15
Figure 1.2	Socialist and Second Economies	26
Table 1.1	Taxonomy of Corruption in Socialist Societies	23
Table 1.2	Estimates of the Magnitude of the Second Economy in CPEs	31

Cuba's First Economy

Table 2.1	Collectivization in Cuba	36
Table 2.2	Agricultural Production Cooperatives (CPAs), 1979-89	38
Table 2.3	Distribution of Land Between State and Private Sectors, on 31 December 1989	39
Table 2.4	Share of the Socialized Sector in CPEs	41
Table 2.5	Monthly Rations per Adult for Selected Products	45
Table 2.6	Prices of Selected Goods in Different Markets, 1977-78	48
Table 2.7	Parallel Market Sales, 1983-88	49
Table 2.8	Average Civilian Employment in the State Sector, 1975-89	58
Table 2.9	Average Civilian Employment in the Industrial Sector, 1975-89	59
Table 2.10	Major Economic Offenses in the 1979 Cuban Penal Code	63
Table 2.11	Economic Crimes in the 1979 Cuban Penal Code	64

Cuba's Second Economy

Table 3.1	Share of the Non-State Sector in Total Agricultural Output, 1970-89	85
Table 3.2	Monthly Fees Payable by Self-Employed Workers	95
Table 3.3	Structure of Agricultural Output, 1970-88	111
Table 3.4	Structure of Civilian Employment, 1953-89	112
Table 3.5	Structure of Population Income, 1975-89	113
Table 3.6	Structure of Population Income, Expenditures, and Excess Liquidity, 1975-89	116

Cuban Economy in Crisis

Table 4.1	Cuban Macroeconomic Indicators, 1981-89	121
Table 4.2	Distribution of Merchandise Trade by Groups of Partner Countries, 1983-89	125
Table 4.3	Commodity Composition of Merchandise Trade, 1988-91	129

Second Economy and Market Transition

Table 5.1	Cuban Citizens Permitted to Own Foreign Currencies, Pursuant to Cuban National Bank Resolution 153/93	164
Table 5.2	Occupations Suitable for Self-Employment	166

Introduction

That Cuba is facing its most serious economic challenge in the nearly thirty-five years of revolutionary rule is not an issue open to debate. Uncharacteristically for matters related to the island, there is consensus among Cuban government officials, analysts on the island, and scholars abroad that the economic crisis of the 1990s is extremely severe. According to information provided by Cuban officials, it can be estimated that the global social product declined by more than 40 percent in 1989–92¹ and by another 10 percent in 1993.²

There is also consensus that, as the official, centrally planned economy (the “first economy”) has faltered, the set of under-the-table, unrecorded, and largely illegal activities that go on daily in socialist Cuba that permit ordinary citizens to eke out a living (the “second economy”) has grown by leaps and bounds. Some analysts (e.g., Domínguez 1993, 102) attribute the survival of the Cuban regime in part to the ability of flourishing illegal markets to meet the consumption needs of the citizenry.

There is no doubt that the economic crisis of the 1990s has propelled the second economy from behind the scenes to center stage. Not only have black markets mushroomed, but second-economy activities that the government traditionally discouraged or even prosecuted have been incorporated into the government’s economic strategy. Self-employment, cultivation of individual plots, and the use of foreign currencies to buy or sell goods are now being promoted with considerable enthusiasm by the leadership.

For obvious reasons, studying Cuba’s second economy is a challenging task. Some second-economy activities (e.g., stealing goods from government workplaces and selling or bartering them) are illegal and transgressors subject to severe punishment if caught; others (e.g., in the early 1980s, the direct sale of agricultural products to consumers by small farmers) have been permitted forms of activity for private gain that nevertheless have been discouraged by the government. Most participants in Cuba’s second economy make it a point to hide their activi-

ties from the authorities. Undue attention drawn to their successes can lead to punishment for committing economic crimes or censure for deviant behavior. The reluctance of second-economy participants to stand up and be counted is typical of this form of activity across all societies.

Even when they are not illegal, there is very little systematic information on second-economy activities in Cuba, since they have not been the government's preferred form of operation. Moreover, participation in them, until very recently, has been officially discouraged. Official statistics, designed primarily to measure the operation of the first, centrally planned economy, tend to ignore the second economy altogether. Only in a handful of areas (e.g., activities carried out by small farmers or cooperatives) are there any official statistics on economic activities outside of the state sector. Similarly, there are no published official studies or tabulations produced by the Cuban government or by researchers on the island that would shed light on the magnitude and sectoral distribution of second-economy activities.

Despite these obstacles, the study of the second economy of socialist Cuba is of critical importance at this time for several reasons. First, its size and dynamism no longer permit students of the Cuban economy, myself included, to sidestep it. It has been common practice for economists to focus only on the first economy—the segment for which data are available, although there are concerns about the quality of those data³—while acknowledging second-economy activities merely with a caveat or in a dangling footnote that admitted that second-economy activities existed but were outside of the scope of their work.

Second, its ability to complement the official, centrally planned economy and correct some of its failures has captured the attention of Cuba's economic policymakers. They are now making the second economy the focal point of their strategy to overcome the economic crisis.

Third, the second economy has the potential to play a positive role in a transition to a market economy on the island. The second economy is, after all, the segment of the Cuban economy that most directly responds to market signals and operates most efficiently. It is a logical reservoir for entrepreneurial talent that could be constructively used in a market-economy setting. Under a free market system, second-economy activities could form the backbone of a private sector composed of small businesses engaged in the production and sale of goods and services.

The aim of this volume is twofold: to sketch the contours of the very complex phenomenon that I call the second economy of socialist Cuba and to discuss its evolution over time and the role that it could play in the transition to a market economy on the island. In carrying out my research, I have relied heavily on the open literature: official Cuban statistics, speeches by Cuban government officials, articles in the Cuban press, analytical studies by scholars residing abroad, and accounts by Western journalists. I have also reviewed the extensive literature on the second economy in other socialist countries and of informal economic activities in developing countries produced by economists, sociologists, and criminologists. Although I have not conducted fieldwork on the island or among emigrés, I have used extensively the results of interviews of emigrés conducted by others⁴ and experiences related to second-economy activities recounted by journalists who have visited the island.

Chapter 1 of this volume reviews different conceptualizations of unregulated economic activities that have been set forth in the literature. It supports the conclusion that the second economy provides a more satisfactory framework for analyzing the specific manifestation of these activities in Cuba than the informal economy. Chapter 1 also formally defines the second economy, sets forth some of the characteristics of centrally planned economies that are deemed to be particularly responsible for its existence, discusses the interplay between it and the first economy, describes methods that have been used to estimate its magnitude in selected centrally planned economies, and presents these estimates.

Given the intimate relationship between the first and second economies, it is essential to know the parameters of the former in order to develop an appreciation for the function and magnitude of the latter. Chapter 2 serves this purpose by briefly describing the institutions that frame Cuba's first economy. The description of the first economy is brief because this is an area in which there is already significant literature. The chapter concentrates on three areas that are particularly relevant to the study of the second economy: the role of the state and property relations in contemporary Cuba, the system of centralized planning and allocation of resources, and socialist legality and the concept of economic crime.

Chapter 3 brings together available information from a multitude of sources on the manifestations of the second economy in Cuba and of its

operation. In particular, the chapter describes in considerable detail economic activities conducted for private gain and those that are illegal, discusses efforts by the government to eradicate illegal economic activities, and gives some indications of the breadth and depth of the second economy using various indirect indicators. The emphasis in this chapter is on the period through the late 1980s, before the Cuban first economy went into a tailspin and the second economy gained its current prominence. Estimates of the magnitude of the second economy end with 1989 since this is the latest year for which reasonably comprehensive official economic statistics are available.

Chapter 4 deals with Cuban economic strategies and performance surrounding the economic crisis of the 1990s. It focuses on the "rectification process" (*proceso de rectificación de errores y tendencias negativas*) that began in 1986 and the so-called "special period in time of peace" (*período especial en tiempo de paz*). It examines the magnitude and causes of the economic crisis and the strategy being pursued by the Cuban government to prevent further economic deterioration. The chapter also examines the tremendous growth of the second economy during this period, largely as a result of the severe economic contraction of the first economy.

The process whereby the second economy has shifted from behind the scenes to center stage of Cuban economic life is the subject of chapter 5. The chapter discusses the range of government policies—whether explicit actions that nurture second-economy activities or a permissive behavior toward activities that were formerly discouraged or persecuted—that have brought the second economy to center stage. It also reviews studies of the positive and negative roles that second economies can play, and have played, in the marketization of former socialist economies. Drawing on this literature, the chapter ends with a discussion of how the second economy could influence Cuba's eventual transition to a market economy.

I trace my interest in systematically examining Cuba's second economy to an invitation from Damián Fernández in 1991 to prepare a paper on informal economic activities in Cuba for a seminar he organized. Titled "*Lo informal: Everyday Forms of Accommodation and Resistance in Cuba in a Comparative Perspective*," the seminar, sponsored by the Cuban Research Institute, Latin American and Caribbean Center, Florida International University, was held in April 1992. The

seminar brought together a group of scholars—sociologists, political scientists, economists, and historians—to examine aspects of informal behavior in Cuba from the perspective of their respective disciplines. Also contributing to the richness of the seminar were testimonies from recent arrivals to the United States from Cuba and a journalist who had written extensively on the subject.

For that seminar, I prepared a paper titled “Cuba’s Second Economy: A First Look,” which surveyed the literature and proposed a series of research questions that deserved further attention. Several colleagues, in particular Irving Louis Horowitz, Alejandro Portes, and Luis Salas read the paper and provided me with comments and suggestions. They also encouraged me to continue working on the subject and to pursue some of the research questions that I had raised in the paper. I want to thank Professor Fernández for inviting me to participate in the seminar, and Professors Horowitz, Portes, and Salas for their very useful comments and reactions to the paper I prepared for that event.

The current volume takes as a starting point the mentioned paper “Cuba’s Second Economy: A First Look.” In the present work I have gone into more depth on many of the topics, incorporated analyses responding to research questions posed in the former paper, and considered the impact of recent changes in Cuba that have altered the role of second-economy activities. The sections of the volume dealing with quantification of the second economy in former centrally planned economies and in Cuba draws heavily from a paper titled “The Cuban Second Economy: Methodological and Practical Issues Related to Quantification,” which I presented at the Second Annual Meeting of the Association for the Study of the Cuban Economy (ASCE), in August 1992.⁵

In closing, I also want to recognize three other individuals who have helped me greatly in this work in different ways. Gregory Schoepfle, a colleague for many years, has taught me a great deal about economic informality in developed and developing countries and has exposed me to the extensive literature on these subjects. José Alonso, Research Department, Radio Martí Program, as usual, has been very generous and supportive, sharing information and discussing with me aspects of Cuba’s second economy. In the last few years, I have had the good fortune of collaborating on several projects with Sergio Díaz-Briquets. Not only have I learned a great deal from our interactions, but our collaborations have turned into building blocks for this volume.

Notes

1. According to Cuban economist Julio Carranza Valdés (1992, 141) Cuba's global social product (GSP), the broadest measure of economic activity available for the official Cuban economy, declined by 3.6 percent in 1990, 24 percent in 1991, and an estimated 15 percent in 1992. Andrew Zimbalist (Preeg 1993, 14) has estimated the 1989-92 decrease in GSP at 45 percent.
2. Estimated by Andrew Zimbalist, as cited in Whitefield (1993f).
3. The classic analysis of the reliability of Cuban economic statistics is Mesa-Lago (1969a). See also Pérez-López (1991a).
4. See the works by Clark and Roca listed in the bibliography.
5. The paper (Pérez-López, 1992b) was included in the proceedings of ASCE's 1992 meetings, published under the title *Cuba in Transition—Volume 2*.

1

The Second Economy: Concepts and Measurement

Entrepreneurial economic activities outside of the scope of public regulation have been found to be present in all societies, albeit in different forms and to different degrees, regardless of level of development or form of economic organization. The variety and complexity of these phenomena is evident from the many names that have been used to describe them: "subterranean," "submerged," "parallel," "hidden," "occult," "informal," "unofficial," "underground," "black," "unobserved," "unmeasured," "unrecorded," "shadow," "illegal," "criminal," "second," "clandestine" (Dallago 1990, xv).

In the last two decades, a vast literature that analyzes these concepts from the vantage point of several disciplines (sociology, economics, anthropology, criminology) has emerged.¹ Many of these contributions consist of case studies of single countries at different levels of development and/or system of economic organization. Similarly, there are also numerous comparative analyses.²

This is not the place to engage in a discussion of these very complex phenomena, their causes, manifestations, articulations with the regulated economy, and implications. The essential point for the purpose of this study is that economic activities outside of official regulations occur whether an economy is organized in the form of state capitalism (i.e., markets) or state socialism (i.e., central planning). They also occur without regard to the level of development of an economy.

Conceptualizations of Unregulated Economic Activities

Three different conceptualizations of unregulated economic activities dominate the literature: (1) the informal economy, typically associ-

ated with subsistence activities in developing countries, particularly those in Latin America; (2) the underground economy, the set of unrecorded, under-the-table economic activities that occur in developed market economies; and (3) the second economy, economic activities outside of the state, or socialist, sector in centrally planned economies.

The Informal Economy

The concept of economic informality first appeared in the development literature in 1972, in a report on employment problems in Kenya. That report made reference to the existence of a large number of "working poor," many of whom were engaged in the production of goods and services, but whose activities were not recognized, recorded, protected, or regulated by the public authorities (ILO 1991, 3).

The International Labor Organization (ILO) Regional Employment Programme for Latin America and the Caribbean (Programa Regional de Empleo para América Latina y el Caribe, PREALC) has been the moving force behind the conceptualization, definition, and measurement of economic informality, especially in Latin America. According to PREALC (PREALC 1981; Tokman 1978, 1987, 1992b), informal sector activities are characterized by:

- low-entry barriers in terms of skill, capital, and organization;
- family ownership of enterprises;
- small scale of operations;
- labor-intensive production with outdated technology (compared to the formal or modern sector of the economy);
- unregulated and competitive markets;
- low, and uncertain, levels of labor productivity and compensation;
- lack of access to credit and financial institutions available to activities in the modern sector; and
- low capacity for capital or wealth accumulation.

Moreover, the informal sector is typically associated with urban-rural migration that has brought masses of job seekers from subsistence agriculture to the modern industrial urban centers and the inability of the modern economy to provide sufficient numbers of well-paying jobs to absorb them.

In addition to PREALC's, at least two other approaches conceptualizing the informal economy have been proffered. The first, associ-

ated primarily with Peruvian economist de Soto (1987), sets out that informality in developing countries results from excessive regulation by the state. Such excess regulations give rise to a myriad of extralegal economic activities, including both market-oriented production and trade as well as direct subsistence, poorly compensated, and low-productivity production.

A second approach, associated with the work of Castells, Portes, Roberts, Sassen, and others,³ defines the informal sector as all income-earning activities that are not regulated by the state in social environments where similar activities are regulated. They regard the existence of the informal economy as due, in part, to alternative forms of labor utilization by larger, modern sector firms, such as casual, off-the-books hiring of workers and subcontracting of production of goods and services to small, unregulated enterprises.

As Tokman (1992b, 4) points out, the different approaches to informality share the belief that informal activities “are performed beyond regulation because of functional requirements alone or mixed with survival strategies, or simply because of an inadequate regulatory system.” They also share the view that informality is a function of excess labor and lack of job opportunities in the modern sector. Finally, they coincide in the finding that, while some owners of informal enterprises and some highly skilled, self-employed workers do have earnings that are comparable or even higher than those of formal sector workers, the vast majority of informal sector workers labor at or below the minimum wage.

The Underground Economy

In the United States and other developed market economies, the taxation system, government regulations, and contractual agreements place certain limits and requirements on the establishment and cost of doing business; the types of activities that can be performed; the conditions of work; the eligibility to work; and the eligibility to conduct a business or carry on a profession (Schoepfle et al. 1992, 5). Economic activities that are conducted outside of these limits and requirements are often referred to as the underground economy.

Tax evasion—the illegal escape from taxes—and the avoidance of governmental restrictions on the activities of economic agents are usually thought of as the major incentives to engage in unregulated eco-

conomic activities in the United States and other developed market economies (Tanzi 1980). Increased taxation and more extensive regulation of economic activities and of the conditions of work and of doing business can also spawn market inflexibilities that provide incentives to go underground to escape them.

The taxation system is believed to encourage some economic activities to go underground so that they can elude tax authorities. For example, the federal income tax system of the United States is based on a progressive rate structure, where higher income levels are taxed at a higher rate. Particularly during periods of inflation, "bracket creep" may occur and increase the incentive for individuals and businesses not to report income.

Government regulation of personal or business economic activities, if effectively enforced with a system of fines and penalties, will tend to increase the cost of doing business. Increased regulation of economic activities may encourage underground activities that attempt to circumvent costly regulations, for example, through the avoidance of occupational safety, health, or environmental protection regulations or the creation of "sweatshops," establishments that are multiple violators of labor regulations.

The Second Economy

The term "second economy" is used to describe widely present unregulated economic activities in socialist economies outside the channels of the official (centrally planned or first) economy and direct state control. Centrally planned economies (CPEs), characterized by very high direct public ownership of resources and highly regimented relationships among economic actors, are fertile ground for entrepreneurial activities outside of the public regulatory framework.

The second economy covers a wide range of activities associated with the production and distribution of goods and services: for example, in the former Soviet Union, it was associated with food production and trade, sale of second-hand goods, medical payments, and a host of services and perquisites; in formerly centrally planned Hungary, it was the dominant form of economic organization in such diverse areas as computer software production and trade, automobile and urban household repair services, foreign language instruction and translation services,

low- and medium-priced tourist accommodations and restaurants, ice cream parlors, urban taxi services, customized entertainment electronics, and high-brow boutiques (Portes and Borocz 1988, 20).

Portes and Borocz (1988, 18–19) describe the economic logic behind the second economy and its manifestation in centrally planned economies as follows:

The central distinguishing characteristic of state socialism is the dominance of the polity over other domains of social reproduction. In these regimes, planning represents, as it were, the gigantic embodiment of social teleology: it is the state's main instrument to insure that its political will should prevail over economic considerations. The bureaucratization of planning and the resulting pervasive shortages of capital, labor, and commodities are the two most common deficiencies of state socialism.

The second economy emerges under such conditions as a partial corrective to the rigidities of the system, thus easing participation in the economy and survival for individuals, households, companies, and perhaps paradoxically, even the state itself. Hence, the appearance of the second economy is the outcome of a combination of state and market factors, not unlike the situation under capitalism. The main difference here lies in the relative strength of market and state with respect to each other—namely, the state's overwhelmingly dominant position under state socialism.

Despite its positive contributions to the national economy and the corrective function it can play by introducing some flexibility into the economic system, the second economy poses a threat to the monopoly of central planning. Thus, the second economy represents a terrain of political struggle, with its boundaries shifting frequently.

Borocz (1993) argues that informality and the second economy are not “extrinsic” or “alien” to state socialism. Rather, they constitute important social, economic, and political counterweights that made these rigidly defined and politically overdetermined societies inhabitable for the population. In his view (Borocz 1993, 233), informality and the second economy

represent strategies of partial exit from, and implicit resistance to, the dominant political-economic paradigm of state socialism, both in theoretical and practical terms, while at the same time, they contribute to its survival by improving its efficiency and, thus, by making state socialist economic practice tolerable.

Hungarian sociologist Istvan Rev (1987, 341) has made the point that in a totalitarian society, when there is no formal framework of political expression, then *everything* becomes a political issue. When an arena for political discourse is absent, then all talk can acquire a political mean-

ing; if people cannot act or speak openly, then all private acts and private speech can be suspected of having a secret political connotation. From this perspective, second-economy activities have more than economic meaning, and also can be seen as evidence of resistance and defiance of the order established by the socialist state.

Many second-economy activities in CPEs are illegal. At times, the state is implacable in its efforts to eliminate the second economy and to prosecute second-economy actors such as black marketers. More often, however, the state seeks ways to accommodate its existence without ceding its prerogatives as the owner and controller of economic resources. Arrangements such as licensing of self-employed workers and free farmers markets, which were widely practiced in the former Soviet Union and Eastern European socialist countries, are examples of efforts by the socialist state to respond to consumer pressures by linking the first and second economies.

In choosing a framework to study unregulated economic activities in socialist Cuba, the two most logical choices are the informal economy or the second economy. As noted above, underground economic activities tend to be associated with avoidance of taxation and reaction to overregulation of private enterprise, a set of conditions that does not fit centrally planned Cuba.

The concept of informality as defined by PREALC for Latin American countries, to the extent that it represents a subsistence strategy, agglomerating self-employed workers, and small, undercapitalized, low-productivity and low-technology enterprises, does have some relevance to the Cuban case. However, an implicit assumption in the conceptualization of the informal economy is that the central government condones these marginal activities and does not seek to eliminate them; while informal units are technically in violation of the law in that they are generally not registered with municipal, tax, and labor authorities, they are seldom prosecuted by the state because they are believed to be precarious and unable to operate—and maintain employment of individuals—if they had to bear the full burden of economic and social costs. Moreover, informality is often associated with rural-urban migration and the inability of the modern sector to generate wage employment.

The concept that is most relevant to the study of unregulated economic activities in contemporary Cuba, and the one used in this study,

is the second economy. This is not to say that certain characteristics of informal or underground economies may not be present in Cuba, but rather that, overall, the most useful framework to describe the phenomenon of unregulated economic activities in socialist Cuba is the second economy.

The framework of study provided by the second economy is congruent with property relations in Cuba, where the state has overwhelming control over productive resources, with central planning, the prevalent form of economic organization, and with full employment policies pursued by the central government. It also fits with the desire of Cuban citizens to improve their economic well-being and the lack of opportunities to do so within the very restrictive official economy. Such a conflict gives rise to entrepreneurial activities that are categorized as being part of the second economy. Finally, the second economy also resonates with Cuba's views on socialist legality and economic crime, and the prosecution of second-economy actors because of their revealed preference to pursue private, rather than societal, gain.

The Second Economy: Control versus Legality

In a seminal article, Grossman (1977) focused on economic activities in the former Soviet Union "where production and exchange often take place for direct private gain and just as often violate state law in some non-trivial respect." He referred to this set of economic activities as constituting a "second economy."⁴ More formally, he defined the second economy (of the Soviet Union) as comprising all production and exchange activity that fulfills at least *one* of the following tests : (a) being directly for private gain; or (b) being in some significant respect in contravention of existing laws (Grossman 1977, 25). This concept is particularly fitting for analyzing activities outside of the scope of public regulations in CPEs, including Cuba.

Grossman's definition of the second economy was criticized (e.g., by Holzman 1981) as being too expansive because it lumps together private economic activities that are legal (e.g., private farming, repair work) with those that are illegal (e.g., black markets). Grossman (1982a, 111) has justified the inclusion of legal activities for private gain as part of the second economy on the grounds that the latter is intended to capture all forms of deviations from the model of a socialist command economy.