"Cuba in Transition Project"
Conclusion and Policy Options of the Economic Cluster

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Cuba is in the midst of an unparalleled economic crisis. Due to the collapse of communism in the former Soviet Union and Eastern Europe, Cuba lost its major economic beneficiaries and has suffered major reductions in trade. The consequences for the economy have been devastating. To cope with the crisis, the leadership has introduced a number of economic reforms, mostly in the external sector. An intense debate is underway in Cuba regarding the country's economic future and how far the economic re form process should go, particularly within the domestic economy.

Within this context, Florida International University, with funding from the U.S. Department of State and the Agency for International Development, launched the "Cuba in Transition" project in the summer of 1992. Organized into two clusters -- polit ical and economic -- the project examined crucial issues related to Cuba's current predicament and what they entail for the future, including an eventual political and economic transition. No attempt was made to forge a consensus among the project's part icipants regarding Cuba's political prospects, and the two clusters (and the researchers within each) worked largely independent from each other. At the project's outset, however, the participants did agree on a general analytical strategy. Each contrib utor was to assess the current situation and consider likely future outcomes and policy options.

The Economic Cluster, for which I served as the Director, consisted of the following researchers and papers:

Jorge Pérez-López, "Learning From Others: Economic Reform Experiences in Eastern Europe, Latin America, and China";
Rolando Castañeda, "Cuba: Central Elements of a Stabilization Program and the Initiation of Economy-wide Structural Reform";
Jorge Sanguinetty, "The Transition Towards a Market Economy in Cuba: Its Legal and Managerial Dimensions";
Archibald R. M. Ritter, "Financial Aspects of Normalizing Cuba's International Relations: The Debt and Compensation Issues";
Sergio Roca, "Cuban Privatization: Potential Path and Implementation"; and
Carmelo Mesa-Lago, "The Cuban Safety Net in the Two Cuban Transitions."

As a result of the project's organizational approach, the Economic Cluster contributors did not base their analysis on a common framework or produce a coherent and comprehensive package of policy options. Rather, they selectively examined important issues that Cuba is currently facing or will have to confront in the eventual transition from a socialist to a market economy. In general, however, there seems to be agreement in the Economic Cluster regarding most of Cuba's future economic options.

Although encouraged but not required to assess the implications of different future scenarios, the project participants were asked to be explicit about the scenario(s) to which their analysis applied. Some Economic Cluster contributors foresee a nea r-term, sudden collapse of the regime (Jorge Castañeda, Jorge Sanguinetty), while others anticipate a more gradual, but equally inexorable, process of change eventually leading to a market economy (Carmelo Mesa-Lago, Jorge Pérez-López , Archibald Ritter, and Sergio Roca). The collapse scenario assumes that the current political leadership will be displaced, whereas under most variants of the gradual transition scenario, it is explicitly or tacitly assumed that the current regime may manage to hold on to power for some time, at least during the earlier phases of the transition.

In the view of the Economic Cluster, Cuba's current economic model is not sustainable. Reforms instituted thus far are insufficient to arrest the country's economic decline, and the international environment does not bode well for the model's succes s. Although a transition to a market economy is still not in the offing -- and since limited reforms are not likely to resolve the country's economic difficulties -- Cuba will have no choice but to intensify the pace of economic reform. Since the projec t was completed, in fact, the socialist government announced in July 1993 further economic reforms. The most important are the dollarization of the economy and a further liberalization of foreign investment rules. Whether or not the present leadership c an continue to institute major economic reforms and retain its hold on power, the end result is likely to be a Cuba very different from that of today.

Foreign Reform Experience

In "Learning From Others: Economic Reform Experiences in Eastern Europe, Latin America, and China", Jorge Pérez-López reviews the economic reform experiences of selected centrally- planned economy countries in Eastern Europe (particul arly Poland, Czechoslovakia, and Hungary) and Latin America (particularly Chile and Mexico) to identify lessons that might be applicable to a transition away from socialism and toward a market economy in Cuba. Where relevant, Pérez-López considers the experience of the People's Republic of China in creating a "socialist market economy". The thrust of the paper is on identifying common themes across reforming countries: policy reform strategies, implementation problems, and outcomes.

According to Pérez-López, the extensive literature on policy reforms in socialist and market economies suggests that initial conditions are critical in the design of a reform strategy. In particular, the design of the reform strategy w ill be heavily influenced by the degree of internal and external macroeconomic imbalance, the extent of centralization of economic management, and the use of product markets rather than planning. Although he finds differences among economists on the spee d and sequencing of reforms -- to a large extent because of different assessments of initial conditions -- there is broad agreement on the elements of a reform program:

€Macroeconomic stabilization: Adjusting fiscal and credit policies, and addressing internal and external imbalances;
€Price and market reform: Removing price controls, liberalizing trade, and creating competitive factor markets;
€Enterprise reform : Private sector development, such as establishing and clarifying property rights, facilitating entry and exit of firms, and restructuring enterprises; and
€Institutional reform: Redefining the role of the state, e.g., through legal and regulatory reform, social safety net, reform of government institutions (tax administration, budget and expenditure control, and monetary control).

The experiences to date of former centrally-planned economies in transition to market economies suggest that there is no single path to reform. The consensus among economists is that countries whose economies face substantial macroeconomic disequili brium at the onset of reforms must tackle these imbalances at once. In so doing, however, it is important: not to bring about misallocation of resources that would impede other aspects of the transition process; and to begin the slow process of creating markets and building institutions that support the market. Most economists are of the view that the sequencing of reform measures, rather than their implementation speed, is the more critical factor in designing a successful reform strategy.

The experience of centrally-planned economies and market economies undergoing stabilization and liberalization suggest that implementation of these policies entails short-term costs in the form of reductions in output, employment, and wages. Notwith standing their short-term costs, such policy changes are essential if former centrally-planned economies are to prepare themselves to reap the long-term benefits associated with a market economy and its insertion into the world economic system. The impor tance of a domestic consensus for reform cannot be overemphasized. Without strong domestic consensus and political leadership, there is a high likelihood that societies undergoing transition would seek to reduce short-term costs and would not take the re quired steps to stabilize the economy and set it on a market-oriented path.

Pérez-López argues that China's economic reform experiences are intellectually interesting, but so unique--because of several endogenous and exogenous factors--that their potential transferability to other nations is almost nil. No oth er reforming country approximates China's huge domestic market, natural and human resource endowments, and international strategic significance. Similarly, the proximity of a world-class trading center such as Hong Kong, and the ability to draw foreign i nvestment through that country, is unprecedented and not likely to be reproducible elsewhere. The conclusion of Pérez-López regarding the inapplicability of the Chinese economic reform model to Cuba is shared by all the other members of the Economic Cluster.

Pérez-López concludes that Cuba faces severe macroeconomic instability, not unlike that faced by pre-reform Poland, pointing to the imperative of making stabilization one of the highest priorities of a reform program. Structurally, the Cuban economy is one of the few remaining bastions of central planning, probably putting Cuba in this regard close to pre-reform Czechoslovakia. Cuba's central planning orthodoxy means that a reform strategy for the country will have to be very comprehe nsive, tackling essentially all areas of the economy. A case can be made that before entering into a transition to a market economy, Cuba has experienced the costs associated with "shock therapy" without the potential benefits associated with systemic tr ansformation. That the Cuban population has already endured severe economic hardships and reductions in the standard of living should be borne in mind in designing a comprehensive reform strategy for the island.

Macroeconomic Stabilization

Rolando Castañeda's paper, "Cuba: Central Elements of a Stabilization Program and the Initiation of Economy-wide Structural Reform", focuses on the main issues Cuba must face once it embarks on a transition to a market economy. Castañe da examines how crucial reforms must be implemented to promote positive aggregate supply responses and investment increases. As such, the paper evaluates the policies that must be instituted to stabilize, restructure, and liberalize the economy. Casta&n tilde;eda considers the mix, sequence, intensity, and speed of reforms.

The stabilization program is based on the goals of defeating inflation after prices are adjusted or liberalized, reestablishing external equilibrium, and transforming the economy from a tightly- centralized system into a market-oriented one. The pro gram synthesizes the ideas of many who have worked in the transition processes, and considers the experiences of many countries, especially of Chile in 1984-1992. Chile, like Cuba, a small, open economy dependent on primary good exports, adopted a profou nd reform package over the last two decades. Chile also represents a successful transition from a highly-inflationary and tightly- controlled economy into a market oriented and stable one.

Castañeda's proposal emphasizes that the Cuban economic system and its organization cannot change immediately and that, therefore, a degree of gradualism in the transition is imperative. The program proposes the combination of fiscal and mone tary correction, as well as incomes policy. Thus, it could be considered as a heterodox stabilization program. Unlike, traditional programs, heterodox stabilization programs do provide an immediate opportunity for initiating basic structural reforms and for evading significant, protracted recession.

Wage-price-exchange rate controls are an essential, but transitory complement to the fiscal monetary stabilization. The central question is to address what causes inertial inflation and how incomes policy can break it. A temporary system of exchange rate-wage-price controls is the coordinating device that establishes that the economy left to i tself cannot establish zero inflation quickly, except at extreme costs in output and employment. The case for active and coordinating role for macroeconomic policy due to information externalities arises because macroeconomic noise and uncertainties are large compared with the microeconomic uncertainties in each individual market and sector.

Castañeda's program calls for reinvigorating Cuba's anemic and shrinking economy and for making Cuba competitive in the global economy. Included are rapid stabilization -- along with price and trade liberalization and partial currency convert ibility -- and an active export policy and external mobilization approach for removing the bottlenecks in key activities and for beefing up import capabilities. Measures proposed are specifically intended to stabilize the Cuban economy, undertake high-qu ality reforms, and reverse its current decline.

Castañeda's proposal consists of a specific, coherent, and consistent set of priorities, policies, and reforms. An integrated approach is essential for deep and broad changes to occur. The main, immediate objectives of the stabilization prog ram are to reduce inflationary pressures and expectations abruptly, eliminate the cause of balance of payments disequilibrium, and reduce policy- induced uncertainties, thus establishing the conditions for restoring economic activity and growth. To achie ve them, Castañeda proposes to carry out a set of well-designed, mutually reinforcing, thorough and transparent macropolicies and institutional and liberalization reforms. Concretely, it plans to eliminate the fiscal deficit, the overvaluation of the exchange rate, the excessive restrictions on foreign trade, the monetary overhang, and the enormous distortions in relative prices.

Also, given the extent of state intervention in every aspect of daily economic life, the program includes measures regarding the liberalization of prices and wages, and basic and comprehensive institutional reform for the expansion of the private sec tor. Because stabilization is not an end in itself, all available fiscal, exchange rate, commercial trade, monetary, price, wage, and external debt policy instruments must be used coherently and consistently with medium-term and long-term growth objectiv es.

General macroeconomic policies without a foreign resources mobilization policy, and liberalization measures without restructuring and appropriate institutional building, will generate a variety of negative side effects and delay the recovery of produ ction. The country needs to grow -- not just languish in stability. Inflation is unavoidable to some extent when stimulating a very flexible economy, but if financial markets turn out to be successful in increasing production in the medium and long run, inflationary pressures will slow down. Therefore, the program incorporates sweeping supply-side reforms to stimulate investment and economic growth.

Castañeda, like other Economic Cluster contributors, cautions that to succeed, these measures will have to be carefully explained to the people to establish confidence and credibility. Also, the authorities need to manage their reform program decisively, with conviction and perseverance, despite it's complexity and comprehensiveness. To the extent that these reforms fail, or if the transition is perceived as being unduly costly, disillusionment and frustration will settle in, generating seri ous social and political unrest with unpredictable consequences.

Institutional and Managerial Issues

Jorge Sanguinetty's paper, "The Transition Towards a Market Economy in Cuba: Its Legal and Managerial Dimensions", provides a broad perspective on the most critical problems of the transition and suggests possible policy options. Instead of focusin g on one particular aspect of the transition process, the paper emphasizes its complexity and the interrelations among economic, institutional, and legal variables.

Once the power of the Communist Party disintegrates, the forces that keep the central planning and enterprise management system (or its remains) in place may also collapse. A transitional government will be faced with the dual tasks of managing the inherited system, while at the same time setting the foundations for a new one. If the economic situation is grave and the new administration weak, lawlessness may erupt and systematic looting of state-owned property may ensue. The top priorities of a t ransitional government will be in the areas of public order and food security. The transitional government will also have to immediately invalidate laws and constitutional articles that prescribe private property, the free hiring of labor, and free market s. Additional emergency measures should include encouraging the formation of small commercial and transportation businesses, maintaining a high level of epidemiological vigilance, keeping a tight managerial control of state enterprises, and facilitating the external transfer of money from relatives of Cubans living abroad, The extreme impoverishment of Cuba will create serious difficulties for a transition to a market economy. The level of external indebtedness, together with the volume of claims for expropriations, will put severe pressure on the transitional government from the beginning, making more difficult the process of economic recovery. An important issue to consider is Cuba's future constitutional framework. While it appears that a ne w constitution will be mandatory, over the short-term it might be more expedient to modify the current socialist constitution rather than adopt Cuba's last pre-revolutionary constitution. The latter has several articles that could interfere with the impl ementation of a market economy.

To carry out a double transition to a market economy and a democratic system, it will be necessary to raise the level of public understanding about basic economic issues. Legal reform will entail evaluating the body of laws, and assessing the charac teristics of legal institutions, the qualifications of judges and other legal personnel, the legal practices that evolved over three decades of socialist rule, and the financial resources needed for a revamped legal system.

Debt and Compensation

Archibald Ritter's contribution, "Financial Aspects of Normalizing Cuba's International Relations: The Debt and Compensation Issues", is based on the notion that a normalization of Cuba's place in the international finance and trading system requires a resolution of its debt problems and of the issue of compensation for the properties of U.S. nationals seized in 1959 1963.
Cuba's convertible currency debt, amounting to about $7.8 billion in early 1993, is very high in a Latin American context, and has been unpaid since 1988. Cuba's ostensible debt with the former Soviet Union and the countries of Eastern Europe likel y exceeded $30 billion by 1992, but its status is ambiguous. Ritter believes that Cuba should be able to reschedule its hard currency debt to the "Paris Club" of official creditors under terms that include debt forgiveness by up to 50 percent, with the b alance being repaid over 23 years with a six-year grace period. These terms would permit Cuba to arrange future servicing of the debt and to recommence using credit normally. Russia hopes to obtain some repayment for its $28 billion debt, but this appea rs improbable.

The second issue examined by Ritter is that of claims for compensation of U.S. nationals whose properties were seized by the Government of Cuba. The value of these properties as certified by the U.S. Federal Claims Settlement Commission, would be ab out $6.1 billion as of mid-1993. Cuba may propose a counterclaim for damages caused by the U.S. embargo and other actions, but this is unclear. International law on the matter of nationalization and compensation seems widely accepted and relatively unam biguous. Basically, countries can nationalize properties for legitimate public purposes, if undertaken non-discriminatorily and non-retaliatorily, and if "prompt, adequate, and effective" compensation is paid. International law is silent, however, on da mages that may be imposed by a large country which imposes economic sanctions or covert destabilization on a small neighbor. In Ritter's view, ideas of equity and fairness do not support the right of a large country to damage a small neighbor.

The compensation issue will have to be negotiated and resolved eventually. Ritter evaluates a variety of possible mechanisms for dealing with the issue. Restitution, or the return of properties to their former owners, probably has only a very limit ed role to play for a number of reasons. Direct financial compensation is out of the question in the near future, due to the severe problems of the Cuban economy and its weak export capability. Some degree of mutual forgiveness of compensation will like ly occur. Particularly useful would be a "generalized voucher system" through which certified foreign claimants (and perhaps Cuban citizens) would be issued marketable vouchers that could then be used to purchase state properties being privatized, acquir e foreign exchange on secondary markets, or invest in mutual funds, venture capital funds, or new institutions. Likely, a hybrid mix of these approaches will be used. The debt resolution and compensation arrangements that are ultimately negotiated will have to minimize the requirement for foreign exchange in the near future due to Cuba's serious economic problems.

Privatization Issues

In "Cuban Privatization: Potential Path and Implementation", Sergio Roca discusses the objectives, methods, and sequencing of a privatization program and presents a privatization proposal. In addition, issues and problems likely to arise in privatiz ing specific sectors, industries, or services are carefully analyzed. When appropriate, the experiences of Eastern Europe and Russia are brought to bear on the Cuban case. An attempt is made to identify sensitive issues of public policy, including the r ole to be played by foreign investment and Cubans abroad. The importance of balancing economic and political objectives is emphasized.

Roca warns that the privatization drive is only one element of the larger effort to create a market economy, thus details of the privatization program do not exist in a vacuum and cannot be outlined in isolation. He also warns that privatization wil l be carried out within a specific political context and by a leadership that must respond to its costs. The most elegant and coherent privatization plan will likely experience significant revisions during its development and implementation.

The basic objective of privatization in Cuba is to change the ownership pattern away from the socialist past into private property and to redirect enterprise goals so that firms begin to base their decisions on profit criteria in a competitive enviro nment. In addition to the promotion of the market system, other goals of privatization include: 1) foster economic democratization by encouraging ownership among the population, 2) generate revenue for the government, 3) develop innovative management and promote economic efficiency in the state enterprises during the transition phase, and 4) preserve as much as possible the equity gains achieved in the areas of education and health.

A mixed approach to privatization should be used with methods and terms based on the type of economic activity and the size of the enterprise. To start, small enterprises in the agricultural, trade, and service sectors should be privatized early and quickly through outright sales or leases to individuals, cooperatives, and other groups willing and able to make such acquisitions. The privatization of large state enterprises should take longer and be conducted by a government created privatization agency of ministerial rank. Provincial and municipal governments should handle the disposal of state-owned assets under their jurisdictions.

The disposition of legitimate legal claims of former Cuban property owners affected by revolutionary laws involves a delicate political problem and represents a major complicating factor to the privatization drive. In general, financial compensation for losses, rather than reinstitution of expropriated property, should be the preferred solution to property claims by former or present Cuban nationals.

What about foreign ownership and international investment? Should there be a limit on foreign investments in the island? It is likely that Cuba, with a historical tradition of nationalism and a renewed concern about economic independence, would be sensitive to excessive foreign economic investments, especially in its key industrial, banking, utilities, and communications sectors. On the other hand, massive amounts of foreign capital will be required for the economic reconstruction of the island. Addressing these conflictive tensions will likely require a highwire act of balancing economic and political criteria. However, the initial push must be on the side of foreign investment and the continued bias should be in favor of foreign capital and te chnology.

Roca offers a brief summary of the extent and sequence of privatization by economic sectors. Small farmers, both those holding pre-revolutionary property titles and those who benefitted from land distributions in the early 1960's, should retain thei r ownership stakes. Cooperatives should have the option of becoming private coops or, if feasible, distributing the land among their membership. In addition, state farms engaged in the production of key domestic foodstuffs (rice, tubers, plantains, vege tables, fruits and dairy products) should also be privatized at an early stage in order to provide incentives for food production and to avoid spiralling food prices. In the housing sector, current occupants should retain their existing status and tenanc y or ownership rights. Sugarcane farms, rice plantations and other large-scale agricultural units will require extensive restructuring before privatization can be attempted.

Safety Net

Carmelo Mesa-Lago begins his paper, "The Cuban Safety Net in the Two Cuban Transitions", by making a distinction between two Cuban transitions: a "socialist" transition underway since 1990 that has introduced very few and limited market mechanisms, a nd a potential "market transition" that he assumes will eventually take place in the future. Mesa-Lago analyzes how each of the transitions is likely to affect the social safety net. The latter embraces six areas: employment-unemployment, social securit y, health care, education, housing, and consumption. The social safety net, in Mesa-Lago's view, must be an integral part of a market-oriented reform to avoid becoming obstacles to the latter and providing minimum social protection during the transition .

Prior to the collapse of socialism in Eastern Europe and the former Soviet Union, Cuba had the most comprehensive, generous, and costly state social safety net among all the community of socialist countries, as well as in Latin America. That feat wa s largely possible because of the enormous amount of economic aid provided by the former Soviet Union and the Council for Mutual Economic Assistance. The disappearance of both of these entities have been largely responsible for Cuba's severe economic cri sis.

The Cuban government has tried to maintain the social safety net in the "socialist tradition" as a mechanism to protect the population and elicit its support, but, as the economy has plummeted, the burden of the social safety net has become heavier (from 17 percent to 26 percent of Global Social Product in 1992) and now it is unbearable. Furthermore the crisis has eroded the social safety net: open unemployment now ranges from 10 percent to 18 percent; the loss in real value of the peso has badly re duced the purchasing power of pensions; the serious scarcity of medicines, spare parts, and food have damaged health standards; lack of paper, books, and other materials has harmed education; the housing deficit has dangerously increased and the deterior ation of the existing stock has accelerated; and the combination of an expansion of the black market (now covering two-thirds of total transactions), record surplus money in circulation, and severe scarcity of consumer goods, have led to skyrocketing pric es for goods, putting them out of the reach of low-income groups.

Cuba has already suffered the loss of economic relations with the Council for Mutual Economic Assistance, which is estimated to be responsible for one third of the economic decline in Eastern Europe and the former Soviet Union, and has taken minor st eps to reinsert itself into the world market. In that sense, the negative consequences of the market transition should be more moderate than in the former socialist countries. On the other hand, Cuba still has the most state owned, command economy in the world, which should exacerbate the negative consequences of the crisis in the market transition. Finally, the severe deterioration of Cuba's social safety net before such a transition takes place should reduce population exp ectations for social protection in the full move to a market economy, but create a grave social situation that must be addressed.

Mesa-Lago provides general guidelines for a social safety net in the market transition, as well as specific, detailed recommendations in each of the six areas selected, trying to balance social and fiscal concerns. If an adequate social safety net i s not provided there will be serious political economic costs: a social consensus would be more difficult to reach, strong opposition to the needed market reforms would obstruct their passage, the probability of violence and authoritarianism would increase, and the risk of massive emigration to the Un ited States would be higher. The social safety net in the market transition should be accompanied by widespread, intelligent information to the population on the priorities of the social program and the fiscal constraints it faces.

Concluding Observations

The Economic Cluster contributors to the "Cuba in Transition" project foresee an inevitable process of economic change in Cuba, with or without the acquiescence of the socialist leadership. The absence of institutional market mechanisms, severe macr oeconomic imbalances, and the burden of an enormous foreign debt will hamper Cuba's transition process. The nature of the economic transition will depend, of course, on future political events and the role played by the current political leadership.

Some scenarios assume that the transition will have to be accompanied by an emergency phase. Restructuring and humanitarian measures implemented during the emergency phase to minimize social and economic disruptions could help set the institutional basis for a post-socialist, market-oriented democratic Cuba.

The market transition should ideally include a social compact to assure social and political stability. It should be responsive to the expectations of Cuba's people and economic realities. How state property is privatized will be an important eleme nt of the social compact. Housing tenancy rights in particular should be guaranteed. To the extent possible, Cuba's extensive social safety net should be preserved. For this to occur, the provision of services should be rationalized and the economy rea ctivated. Foreign investment and technology will be essential components of the recovery, and debt and compensation issues must be addressed. A positive environment for foreign direct investment must be sensitive to the country's nationalistic history. The emigre community will have a major role in Cuba's economic recovery.