From Planning to Market: A Framework for Cuba

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2008 Cuba: Updating Socialism (*Actualización*)

- Cautious shift from planning to market
- Hundreds of thousands of public employees being released
- Self-employment and small businesses (*cuentapropismo*)
- Leasing state installations: barber shops, beauty shops, taxis or land
- Free Trade Zones: E.g. Mariel Export Processing

Cuba: From Planning to Market

CEE and Asian cases suggest that Cuba faces a bumpy road from planning to market because:

- No appropriate economic structure for significant changes
- No incentives for genuine reforms: e.g. Venezuelan and Chinese subsidies
- Lack of real political (top-down) commitment for market reforms
- Lack of bottom-up driving forces and ‘buffers’ in the case of economic crisis

Possible Frameworks: Post-socialist Transformations in CEE and Asia

- Four ideal-typical pathways
  - China
  - Vietnam
  - Eastern Europe (former Soviet Union states)
  - Central Europe (Hungary, Poland, Czechoslovakia etc.)

- Four main moments
  1. Centralized state socialism
  2. Reform socialism
  3. Actual transition process
  4. Market economy: Main outcomes

Centralized State Socialism: Similar in all Socialist Countries (1950s-1960s)

- One-party states, legitimated by the ideology of Marxism-Leninism
- Little or no individual private ownership of the means of production *(Kornai, 1992)*
- Giant-sized socialist firms: Created and managed through centralized administrative measures *(Fischer & Gelb, 1991)*
- Centrally-planned, command economies: Prices & markets play minimal allocative roles
- Soft budget constraint: Firms are not motivated to be efficient because they survive anyway *(Kornai, 1998)*
- COMECON: Socialist market area

Cuba 2013: Still Closer to the Centralized Model

- Strong and direct state ownership
- Strict state control over the centrally-planned economy
- Private entrepreneurship is rather limited
- Economic Freedom Index (2012): Cuba ranked 176th of 177 countries, just before North Korea

Beyond the Common Features: Structural Differences between CEE and Asia

- CEE (1960s-1970s)
  - Urban societies
  - Overindustrialized (heavy industry)
  - Strict central plans
  - Labor force: Employed in the huge public sector
  - Heterogeneous workforce

- China & Vietnam (1960s-1970s)
  - Relatively young population
  - "peasant" societies
  - Agricultural
  - Weaker central plans
  - Regional governments: Greater autonomy
  - Labor force: Rural communes
  - Homogenous workforce

Cuba's Current Economic Structure: Closer to CEE than Asia?

(Dapice, 2005; Brundenius, 2013; Sweig, 2013)

- Ageing population (20% is 60 or older)
- Urban population (75% in urban areas)
- Labor force: only 20% employed in the agriculture
- Labor force: 74% employed in the public sector

But:

- Cuba 2013: Most public sector employees are in the service sector (75%)
- CEE (1960s-1970s): Most public sector employees are in the industry

Economic Crisis in Socialist Countries by the 1960s-1970s

- Overcentralized economic systems and soft budget constraint led to crucial economic difficulties in many socialist countries (*Kornai, 1959*)
- Central planning failed: Huge gaps between the unrealistic targets and the actual performance
- Even famines happened in some countries in the 1960s
- The Cuban economy was doing relatively well during this classical socialist period due to the massive Soviet assistance & skyrocketing sugar prices *(Pinkstone & Farrell, 1997; Mesa-Lago, 1981)*

Top-down Reforms and Decentralization

(Gupta, 1980; Balassa, 1970; Lin, 1995; Watts, 1998; Sachs et al. 1994)

- Reform socialist countries:
  - Hungary (1968): New Economic Mechanism
  - Yugoslavia (late 1960s)
  - China (1978): Deng Xiaoping
  - Poland (1981): Commission for Economic Reform: decentralization
  - Vietnam (1985): *Doi Moi*
- Countries, remained Centralized
  - Soviet Union (though modest Lieberman reform of 1965)
  - Czechoslovakia
  - East Germany
  - Bulgaria
  - Romania
- Cuba: Some tentative market reforms in the 1990s due to the collapse of the Soviet bloc. Orthodox communist reaffirmation in the 2000s. Venezuela and China: Cuba’s new rescue.

Second Economy: Bottom-up Market Mechanisms

(Smith & Swain, 1998; Stark & Nee, 1989, Stark, 1989)

- Second economy → Created functioning market institutions
- Neither "illegal" nor legalized by the state (Hungary)
- Second economy: More efficient and innovative than the classical socialist one
- Incentives: 2-4 times higher salaries
  - Innovative cooperation between workers from different fields to deal with special problems
- In Hungary 1980s: Second economy added 20% of the GDP and about 75% of all households received some income from this informal sector
- China & Vietnam: Socialist entrepreneurs are bottom-up driving forces of marketization
- In Vietnam real-life capitalist experiences: About 50% of agricultural workers had lived under a market economy until 1975

Four main pathways from planning to market

(Szelényi, 2008; Szelényi, 2013)

- *China:*
  - Gradual transformation controlled by the socialist developmental state
  - Opened its economy for FDI
  - Township and village enterprises (TVEs)
  - Export-oriented zones
  - Administratively and economically decentralized but politically highly centralized
- *Vietnam:* Similar to China except the rapid and radical character of changes (Shock therapy)
- *Central Europe:* Shock therapy in 1989 but reforms and second economy had already created well-functioning market institutions
- *Eastern Europe:* Shock therapy in 1989 without functioning market institutions: Robber barons; oligarchs and neo-patrimonial state

The Price of Marketization *(Kornai, 1993)*

- China & Asia: Emerged unscratched from the marketization process
- Eastern Europe (early 1990s): Deep and prolonged social/economic crisis
- Central Europe (early 1990s): Severe socio-economic crises but quick recovery by mid-1990s

The Role of the State in Asia

- State institutions remained strong during the whole transformation from planning to market
- Expenditure for ‘ordinary government’ (public education, health care, infrastructure, fundamental R&D etc.) as a percentage of GDP remained largely unchanged *(Popov, 2009)*
- No internal disruption of the state sector, but rather the parallel creation of a new privatized economy
- Large-scale privatization of state assets that did not happen in China and Vietnam
- Administratively and economically decentralized but politically highly centralized single-party systems

The Role of the State in CEE

- In CEE centralized and robust communist state structures suddenly lost their strength after 1989
- Weak states in CEE were the main reasons of crisis
  - Liberal economic agenda: No need for political institution building because market would force the emergence of such institutions
  - Weak states were unable to enforce rules and maintain marker order
  - Collapse of state institutions: Shrinking government revenues and expenditures in GDP
  - After 1989: Unprecedentedly rapid and unregulated large-scale privatization
  - State capture: Powerful interest groups obtained state assets during the privatization of state assets
  - In Central Europe regulatory states emerged only in the mid-1990s when interest groups had already reallocated the formerly communist resources: Oligarchs, Robber barons etc.
  - In Eastern Europe “neo-patrimonial” states emerged

Cuba: Sino-Vietnamese Model without Appropriate Economic Structure

Cuba is trying to follow an Asian pattern with an economic structure similar to Eastern Europe *(Yamaoka, 2009)*

- Low level labor force in the agriculture: No chance for an Asian-type agricultural growth
- Emerging highly taxed non-state sector cannot compete with the huge subsidized public sector
- Transformation/transition would not be possible without significant restructuration of the public sector and probably large-scale privatization

No Incentives for Real Reforms

- In socialist countries real reforms were always triggered by severe economic crisis
- With Venezuelan and Chinese subsidies there are still alternatives for genuine economic reforms in Cuba
- Free Trade Zones without liberalized labor market: FTZs work only with cheap labor and with access to the US market?
- Contradictory signals from the government: E.g. recent prohibition of the private sale of imported goods and private home-based movie theaters

Where are the bottom-up social forces to drive marketization in Cuba

- There is no prosperous and large private sector able to absorb hundreds of thousands of fired public employees
- People fired in the public sector may end up as unemployed and inactive population
- Least educated are most active in the emerging private sector
- Self-employment is limited to low-level service jobs (barber shops, taxis etc.)
- Well-educated and innovative actors are banned from private business
- Entrepreneurs work way below their professional potential and outside the field of their education
- There are no products Cuba could export and might be the basis of a Sino-Vietnamese style export oriented development
- Merchandise export counts less than 10 % of the national output

Suggestions

- Chinese-type gradual transformation
- Without a significant ‘second economy buffer’ a Vietnamese-type shock therapy would be disastrous
- Strong state is needed in order to keep the institutional structure together and preserve market order
- Let innovative well educated people start their private business
- Introduce hard budget constraint and allow private enterprises to compete with state owned companies
- Get access to the US market?
- Introduce real market mechanisms in FTZs.

Thank you!

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