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Cuba's Economic Future: The Search for Models

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EXECUTIVE SUMMARY

Although Cuba continues to be committed to Marxist economics, in the future the island is likely to grapple with the challenges of market-oriented reform that have been faced by a range of socialist and post-communist countries. This paper examines the paths towards reform experienced by the countries in the former Soviet bloc, including Russia, various Eastern European countries, and Central Asian Republics, as well as by the East Asian countries of China and Vietnam, in order to provide important perspectives on Cuba's eventual economic transition.

The countries examined have chosen a variety of approaches to economic and political reform, often with mixed results, each offering specific lessons that will be useful to Cuba's future. At the same time, several general lessons can be drawn from these different experiences. Without question, significant market-oriented reforms are required to enable centrally planned economies to recover and grow. While expanding the space for entrepreneurial activities, the central government must remain competent to design and implement economic policy. Countries with weak governments have typically not fared well during the transition period, allowing for the rise of corruption and political instability. Not all institutions developed for central planning need to be destroyed and replaced; some can be reformed to more effectively regulate a market economy. However, the experiences of other countries suggest that while gradualism can provide a useful way to prod an economy forward, it cannot replace a more far-reaching reform strategy. Another key lesson is that investing in the health and education of citizens is important for centrally planned economies that are opening up to market forces and attempting to compete in the global economy. Finally, Cuba could benefit from technical exchanges, training and development with international financial institutions (IFIs), and an economic policy dialogue on the challenges facing the country's integration into the global economy.

RÉSUMÉ

Bien que l'économie de Cuba soit toujours marxiste, dans les années à venir l'île va probablement se trouver confrontée aux défis d'une réforme axée sur le marché, comme cela a été le cas pour plusieurs pays socialistes et post-communistes. Le présent document examine les voies qui ont menées à une réforme dans divers pays de l'ancien bloc soviétique, notamment la Russie, dans des pays d'Europe de l'Est et les républiques d'Asie centrale, ainsi qu'en Chine et au Vietnam, en Asie de l'Est. Cette analyse permet de fournir des perspectives intéressantes sur une éventuelle transition économique à Cuba.

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Les pays étudiés ont choisi différentes approches pour entreprendre une réforme politique et économique, souvent avec des résultats différents. Chacun offre des leçons spécifiques qui seront utiles pour l'avenir de Cuba. Dans le même temps, plusieurs leçons générales peuvent être tirées de ces différentes expériences. Il ne fait aucun doute qu'il faut des réformes axées sur le marché de grande envergure pour permettre aux économies centralement planifiées de se redresser et de croître. Tout en donnant plus de place aux entreprises, le gouvernement central doit avoir la compétence requise pour élaborer et mettre en œuvre une politique économique. Les pays ayant des gouvernements faibles n'ont en général pas bien vécu la période de transition et ont connu une progression marquée de la corruption et souffert d'instabilité politique. Il n'est pas nécessaire de détruire et de remplacer toutes les institutions en place dans un système centralement planifié; certaines peuvent être réformées pour assurer une réglementation plus efficace d'une économie de marché. Toutefois, l'expérience d'autres pays montre que même si une politique gradualiste peut être un moyen valable pour faire avancer l'économie, elle ne peut remplacer une stratégie de réforme de plus grande portée. Une autre leçon essentielle est qu'investir dans la santé et l'éducation des citoyens est important pour les économies centralement planifiées qui s'ouvrent aux forces du marché et qui tentent d'être concurrentielles au sein de l'économie mondiale. Pour conclure, Cuba pourrait tirer avantage d'échanges techniques, de formation et de développement avec des institutions financières internationales et d'un dialogue de politique économique sur les enjeux de l'intégration du pays dans l'économie mondiale.

RESUMEN

Aun cuando Cuba continúe empeñada en mantener su modelo económico marxista, es muy probable que en el futuro tenga que enfrentarse a los desafíos de las reformas propias de una economía de mercado, al igual que han hecho otros países socialistas y ex comunistas. Este trabajo aborda las vías hacia las reformas seguidas por un grupo de países del otrora bloque soviético, entre los que se encuentran Rusia, algunos países de Europa Oriental y de Asia Central, así como China y Vietnam en el Oriente Asiático, para ofrecer algunas ideas de interés relacionadas con la posible transición económica futura de Cuba.

Los países analizados han empleado métodos diversos para realizar sus reformas político-económicas, a menudo con resultados disímiles, y cada uno ofrece lecciones específicas que pudieren servirle a Cuba de experiencia en el futuro. Al mismo tiempo, de estas experiencias diversas podrán extraerse algunas lecciones generales. Sin duda alguna, se hace necesario aplicar reformas sustanciales de mercado en las economías centralizadas para que puedan recuperarse y crecer. El gobierno central, a su vez, deberá ser capaz de diseñar e implementar políticas económicas mientras amplía las oportunidades para el intercambio entre las empresas. Aquellos países que han tenido un gobierno débil por lo general no han tenido éxitos en la etapa de transición, al permitir el aumento de la corrupción y la inestabilidad económica. No se hace necesario eliminar o reemplazar todas las instituciones propias de la economía centralizada. Algunas pueden reformarse para que resulten eficaces al regular una economía de mercado. Sin embargo, las experiencias de otros países indican que aunque los cambios graduales pueden servir para hacer avanzar la economía, no podrán sustituir la aplicación de una estrategia de reformas más abarcadora y profunda. Otra lección fundamental es que resultan fundamentales las inversiones en salud y educación de la población en aquellas economías de planificación centralizada que comienzan a abrirse a las fuerzas del mercado e intentan competir en la economía mundial. Por último, Cuba pudiera beneficiarse de los intercambios tecnológicos, de la capacitación y el desarrollo que proporcionan las instituciones financieras internacionales, y del diálogo sobre políticas económicas referido a los retos que enfrenta el país al integrarse a la economía global.

Introduction

In January 2006, the government of President Fidel Castro is set to mark its forty-seventh anniversary at the helm of Cuba. As the only surviving communist regime outside of East Asia, the Cuban system has withstood the collapse of the Soviet Union and resisted the sweeping transition from socialism experienced by the countries of Eastern Europe. Although Cuba today exhibits a commitment to Marxist economics that is nearly unrivalled in the world, in the future the island is likely to grapple with the challenges of market-oriented reform that have been faced by a range of socialist and post-communist countries. Of course, the shape of Cuba's post-Castro politics will have an important impact on the willingness of new leaders to embrace a more open economic system. It is certainly possible that a dramatically different Cuban political regime will attempt a comprehensive transition away from communism, as occurred in Russia and many countries in Eastern Europe, but the island's future decision-makers may also choose a more gradual approach.

In all transition countries, economic policy decisions have had important political consequences. While democracy does not automatically generate prosperity, economic isolation definitively breeds poverty. If Cuba achieves economic growth that is broadly equitable, this will generate political support for any government in power. Conversely, economic stagnation or deterioration will undermine the legitimacy of any future political regime, irrespective of whether it is democratic or authoritarian in nature. Although there is no single country or region that provides a precise model for Cuba's eventual economic transition, the experiences of the former Soviet bloc and China and Vietnam offer important perspectives.

Russia had deep ties to Cuba for the three decades prior to the collapse of the Soviet Union, and this partnership profoundly shaped Cuban economic management. The demise of Soviet communism dealt a deep economic and psychological blow to Cuba from which the island still has not fully recovered. The Central Asian Republics similarly suffered after the end of the Cold War, and none has yet achieved full market liberalization. While the countries of Eastern Europe have fundamentally broken with their communist past, the reform process was often difficult and uncertain. In East Asia, China and Vietnam remain governed by variants of the Communist Party, even though they have significantly opened their economies and incorporated market forces. While it is tempting to argue that Cuba must choose between the "shock therapy" of Russia and Eastern Europe or the "market socialism" practiced by China and Vietnam, the reality is that economic transition has proved to be a complicated process with contradictory lessons for post-Castro Cuba.

Russia's Rebirth

It is difficult to exaggerate the impact that the collapse of the Soviet Union had on the Cuban economy. The island's GDP shrank by one-third in the early 1990s, and still has not recovered its pre-1989 level. Many Cubans regarded the subsequent lawlessness and crony capitalism of Russia's early transition years as an object lesson in the type of transition that the island should struggle to avoid. Nevertheless, the emergence of modern Russia ranks as one of the most significant political and economic transitions in the last century, and it holds important lessons for Cuba. Russia's experience demonstrates the degree to which mistakes in the reform process can pose deep challenges to democratic consolidation and retard economic performance.

The future Cuban economy will need to establish clear lines of demarcation between public and private interests, but Russia's reform process shows what happens when new boundary lines between the state and the economy are poorly defined. High-level party officials—known as the nomenklatura—quickly moved to retain their positions of privilege and influence as the ruling oligarchs in the new system. The sudden lurch towards capitalism allowed them to ensconce important advantages for key groups in both the public and private sector through new laws, decrees, and regulatory policies.

Russia therefore presents a cautionary tale for Cuba that should not be taken lightly. Both countries share the characteristics of highly concentrated economic power, underdeveloped political systems, and weak civil societies. Today, Russian democracy continues to live in the shadow of widespread state theft and asset-stripping that constituted the original sin of the region's new capitalism. In particular, Russia's experience with privatization had negative long-term repercussions.

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The government of Boris Yeltsin implemented the initial "voucher" stage of enterprise privatization in 1992, distributing 150 million privatization vouchers to the population for investment in state-owned enterprises at public auction. Within five years, about 130,000 enterprises had become privately owned or stock corporations, representing nearly half of all non-agricultural entities. Yet ordinary citizens were largely excluded from the process, due to lack of information, limited transparency, and insufficient knowledge about how to pursue their ownership rights. By contrast, shrewd enterprise managers quickly moved to buy controlling shares in pre-transition enterprises, often at prices far below the actual value.

Russia's second wave of privatization only deepened corruption-fuelled inequality through the "loans-for-shares" scandal that allowed giant Russian companies to be turned over to private investors at bargain-basement prices. In 1996, the government defaulted on enterprise loans that allowed a handful of oligarchs to claim state assets as collateral and created a class of instant billionaires that acquired companies in important sectors like oil, natural gas, and telecommunications. The Russian parliament later concluded that potential revenues for this stage of privatization were under-collected by a factor of 280. As noted by Joseph Stiglitz, the former chief economist of the World Bank, the result was that "a few friends and associates of Yeltsin became billionaires, but the country was unable to pay pensioners their $15 a month."

Russia's troubled reforms produced potent disappointment with democracy, and this cycle could potentially be repeated in Cuba after Castro. In the Russian case, the massive enrichment of a relative few seemed even crueler because it coincided with a steep drop in economic output and sharply rising poverty and inequality. The poor thus suffered twice over—once when their existing safety nets disappeared, and again when public resources were stolen and international assistance was misdirected. The economic breakdown had severe social consequences. Substantial hardship resulted from the country's bout with hyperinflation in 1992, which caused real incomes to plummet amid surging unemployment, and the subsequent collapse in savings during the 1998 ruble devaluation. Although the decline in living standards was widespread, single-parent families and elderly retirees were the most deeply affected. Fraying social safety nets reduced access to health care and resulted in unpaid pensions for millions of workers. Life expectancy sharply declined during the transition, while rates of alcoholism and disease soared. Russia is today struggling to overcome the acute shortages of medical supplies of the 1990s, while faced with a severe HIV epidemic that threatens a wide swath of the population.

In 2006, Russia's political and economic growing pains will continue to vex the international community, and its transition process provides an unlikely model for Cuba. Russia has made great strides forward in expanding economic liberty, but the capture of important enterprises by a relatively small number of oligarchs continues to hamper the country's economic performance. In the early 1990s, Russia was ill-equipped to create the institutions needed to regulate a market economy, and flaws in privatization, tax administration, banking laws, and the legal system have contributed to corruption and widespread lack of respect for the rule of law. President Vladimir Putin shows signs of resurgent authoritarianism, and his government continues to grapple with flawed economic reform processes set in motion by his predecessor, Boris Yeltsin. However, Cuba could improve upon Russia's performance by creating a more transparent privatization process to accompany price liberalization, and by focusing on improving social policy in health and education, which crumbled in the wake of the Soviet Union's demise. Though flaws are inevitable, Cuba's eventual emergence as a recognizable free-market democracy will be considerably advanced if the island avoids repeating the mistakes of its former patron.

Eastern Europe: Divergent Paths

Many analysts have argued that Cuba should follow the "Eastern European" model of economic reform, which combined a political transition towards democracy with substantial market reform. While the region did experience a wave of democratization after the fall of the Berlin Wall, the process of market liberalization varied widely among different countries. It is true, however, that Eastern Europe experienced a less severe economic collapse than the Soviet Union—the region's GDP dropped by 15 percent, compared to Russia's nearly 50 percent plunge. Eastern Europe likewise experienced a shorter economic decline, averaging 3.8 years of negative GDP growth compared to 7 years for Russia. The Czech Republic, Hungary, Poland, and Estonia quickly liberalized their economies and attracted millions in foreign direct investment. By contrast, countries like Bulgaria, Romania, Slovakia and the former Yugoslavia struggled to find their economic footing in the post-Soviet world. Still, many of the Eastern European countries confronted challenges similar to those that will lie ahead for Cuba, and the island can benefit from learning the right lessons from this region's post-communist transition.

While the region did experience a wave of democratization after the fall of the Berlin Wall, the process of market liberalization varied widely among different countries.

Poland had already planned a mass privatization through vouchers in 1990, and the government eventually pursued a diverse range of options, including public offerings, sales of enterprises to domestic and foreign investors, and conversion into joint stock companies. By 1999, more than 90 percent of Poland's agricultural land was privately owned, and the tax and banking systems had undergone substantial reforms. Poland also overhauled its legal system to ensure greater respect for property rights, and an explosion of new privately-owned businesses allowed the private sector's share of GDP to swell to over 50 percent. Hungary similarly moved to abandon central planning, embracing a series of key reforms to improve the tax structure, the legal code, and management of corporate enterprises. Hungary's government also aggressively attacked problems in the banking sector to streamline regulation and bankruptcy procedures, while cleansing bad loans from the system. The privatization process was quickly opened to foreign capital, a bold move that attracted needed investment and know-how from abroad.

By contrast, the Czech Republic and Slovakia took more complicated and divergent paths towards economic reform. Separated in the "Velvet Divorce" of January 1, 1993, the two countries soon parted ways on economic policy. Unlike Hungary and Poland, the Czech Republic had not experienced a gradual economic opening prior to the Soviet Union's collapse. As a result, deep concern about a possible reversion to communism drove some of the early reforms. Czech policymakers believed that nothing could be gained from an evolutionary approach, and instead sought a speedy and massive transfer of state-owned enterprises to the private sector. An initial wave of voucher privatization took place while the Czech Republic and Slovakia were still unified, and Czech authorities rapidly engineered a second wave shortly after gaining independence. In contrast, Slovakia conducted its second wave of privatization through direct sales that favoured politically-connected parties over ordinary investors. The subsequent performance of privatized entities suffered from the weak regulatory environment and corruption that pervaded these countries at the time ownership was transferred. Both nations also unnecessarily delayed vital banking reforms. The Czech Republic did not privatize banks until the late 1990s, at a cost of nearly one-fifth of annual GDP, while Slovakia focused on bailing out banks without deeper structural reform.

Not all Eastern European nations were anxious to end their long reliance on central planning. Bulgaria, for example, lacked widespread disenchantment with its pre-reform economic system, in part because the country had avoided the major economic crises that had affected other members of the Soviet bloc. Unlike some of its neighbours, Bulgaria declared a moratorium on debt repayments that effectively cut it off from capital markets for much of the 1990s. In 1997, the country's failure to create a market-oriented banking sector provoked a profound financial crisis that mired the economy in severe hyperinflation. This economic shock eventually forced the government to push through more substantive reform after years of gradualism. Although the country had made progress on small-scale privatization, only in 2001 did the privatization of large-scale enterprises begin in earnest.

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In the future, Cuban authorities will want to avoid the corruption that has plagued even the Eastern European countries with relatively successful transitions. In the Czech Republic, nearly three-quarters of the population consider themselves to be victims of illicit schemes perpetrated by the rich and powerful, and international reports suggest that bribery or political connections are often required to win government contracts. Slovakia, the sister republic, suffers from similar problems, despite increased anti-corruption measures, including reforming public administration and passing criminal statutes against racketeering, bribery and fraud. Poland has tried to clean up its economy by cutting red tape, raising civil service salaries, and investigating government wrongdoing more aggressively. In Hungary, corruption is not uncommon but is less debilitating than in the three countries just described. Only tiny Estonia and Slovenia have managed to keep corruption to more manageable levels, in part because these countries had fewer vested interests and more developed civil societies at the time of transition. Although Eastern Europe's shock therapy has reaped important economic dividends, the region has not yet managed to shake off all the cobwebs of central planning.

Several important lessons emerge for Cuba from the range of experiences in Eastern Europe. In all instances, domestic politics shaped the decisions that were taken regarding economic transition, and the reform process moved more slowly in countries like Slovakia and Bulgaria where communism remained relatively popular. If Cuba's future political leadership wishes to undertake more dramatic change, then it will have to invest considerable effort in persuading the public about the importance of market reform. Cuban policymakers may be tempted to liberalize prices gradually, but in several Eastern European nations this decision led to severe economic distortions that ultimately culminated in crisis. The countries that quickly abolished price controls were better able to manage inflationary pressures than those that clung to obsolete pricing systems. As with Russia, however, failure to guard against corruption undermined the market reform process in Eastern Europe, and Cuba will need to remain vigilant to prevent graft or theft of state assets. Finally, harnessing foreign knowledge proved to be a crucial advantage for countries like Poland and the Czech Republic, whereas nationalist resistance to foreign direct investment hampered many other economies in the region. Given the deep roots of Cuban nationalism, this lesson will hold particular resonance for the post-Castro era.

The Central Asian Republics: Too Little, Too Late

Central Asia is perhaps the most overlooked region in the study of economic transition, despite representing a crucial aspect of the post-Soviet landscape. For five states in particular—Kazakhstan, Kyrgyzstan, Uzbekistan, Tajikistan and Turkmenistan—the challenges of economic transformation have been particularly daunting. In Central Asia, dominant political currents have weighed as heavily as economic indicators in shaping the process of reform, and the combustible nature of the region's social panorama has fuelled political conflict and exacerbated governance problems. Although Cuba is geographically remote from this region, these countries reveal important lessons about the difficulty in overcoming initial limitations and harnessing natural advantages to compete in the world economy.

The countries of Central Asia reveal important lessons about the difficulty in overcoming initial limitations and harnessing natural advantages to compete in the world economy.

As with Cuba, the Central Asian states experienced an especially severe economic decline in the wake of the Soviet Union's collapse. While economic performance for all five countries has shown signs of recovery since 1998, these nations are still below their GDP levels of a decade ago. Although Kyrgyzstan and Kazakhstan embraced reform fairly quickly, the full effects of their transition processes are still unfolding. Uzbekistan charted a mixed path, emerging from the Soviet bloc without the severe economic decline experienced by its Central Asian neighbours. Tajikistan and Turkmenistan have been the slowest reformers and chronic economic under-performers, the former burdened by a brutal civil war and the latter by eccentric authoritarian rule.

Despite radically different starting points, Kyrgyzstan and Kazakhstan have emerged as the most rapid reformers in Central Asia. Resource poor and sparsely populated, Kyrgyzstan had few economic advantages to exploit, whereas the relatively well-endowed Kazakhstan, with three times the population, had a deeper pool of labour and geographical advantages. Both countries clearly exhibited a greater degree of political willingness to embrace reform, and they present interesting examples of the importance of speed in reforming transition economies. Kyrgyzstan, inextricably tied to the Soviet infrastructure, had few options to sustain itself apart from the alluring promises of market-led development. Kazakhstan, by contrast, moved ahead with reform in order to capitalize on foreign interest in its natural resources, especially oil. Not surprisingly, the results have been varied. As the most economically liberalized Central Asian state, Kazakhstan has been dubbed the "leader of the pack." In comparison, Kyrgyzstan's underdevelopment persists, and corruption, poor distribution channels and inefficiency remain entrenched.

The Central Asian Republics have chosen markedly diverse approaches to opening their economies, ranging from the rapid liberalization of Kazakhstan and Kyrgyzstan to the continuation of Soviet-style central planning in Turkmenistan. Uzbekistan achieved some success using a mixed economic model accompanied by innovative social policies, while Tajikistan spent the first five years of independence locked in civil war and has only recently begun to pursue economic reform. These nations remain among the poorest and least free of the Soviet Union's successor states, and even those countries with abundant natural resources have failed to achieve adequate growth. Despite many differences, the economic performance of the Central Asian Republics ranges from undistinguished to tragic, burdened by the twin legacies of hidebound bureaucracies and deep social tensions left behind by the Soviet era.

In particular, Cuba will need to avoid the trap of "partial reform equilibrium" that has undermined the Central Asian Republics over the last decade. In many ways, Cuba is better positioned for integrating into the world economy, due to its more diversified exports, proximity to the major U.S. market, and its easy access to key maritime routes. By contrast, the Central Asian Republics, landlocked and isolated from non-Soviet markets, became over-reliant on natural resources and eschewed more comprehensive policy reform. Cuba's economy has the potential to outperform these countries by breaking through the policy paralysis that continues to grip this region of the world.

China: The Rising Dragon

The Chinese model holds both great promise and great peril for Cuba. Over the past decade, China's remarkable economic expansion has allowed it to reduce mass poverty and emerge as a major force on the world stage. The Chinese reform path suggests that a highly centralized political structure facilitated, rather than hindered, the country's impressive social and economic development. China is beginning to change its political institutions in a very deliberate way, with a new generation of leaders cautiously opening the political system to become more representative. With a population of 1.3 billion, much of China's newfound heft stems from the fact that it is the most populous country in the world. China also derives economic strength from a very significant urban population that is much larger than the total population of either the European Union or the United States.

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How did China achieve so much over such a short period of time? China's leaders have implemented a number of policies that set in motion radical reform of its centrally planned economy. In the 20 years between 1960 and 1980, the Chinese succeeded in reducing both the birth and death rates by nearly one-half. By 1980, China had reached a level of social development comparable to that of the middle-income countries, even though per capita income hovered at about $280. The rate of GDP growth began to pick up in the 1980s following widespread institutional reforms. Over the last decade, China's GDP has expanded at an average of nearly nine percent a year. In the last two years, exports grew by about 20 per cent and the value of trade exceeded half-a-trillion dollars. Foreign direct investment similarly grew to a record $57 billion in 2002, and the Organization for Economic Cooperation and Development has predicted that China will surpass the United States to become the world's largest exporter by the end of this decade. China's leadership has come to rely on maintaining these high rates of economic growth to ensure the country's continued political stability.

There are clearly several areas where Cuba could benefit from the Chinese experience. In the 1980s, China provided incentives to producers that revolutionized the agricultural sector, and Cuba would do well to emulate this more comprehensive agricultural reform. In fact, Cuba could compress China's second and third phase of reforms into one phase. Instead of waiting for the peasants to accumulate savings, it could open up small-scale manufacturing, commerce and transport immediately for private and collective investment. China is currently undertaking the important but difficult task of reforming the large and inefficient state sector. As Cuba opens up and begins to integrate itself into the global economy, its economy will develop a strong service sector.

Whereas China is leveraging its power in light manufacturing to integrate itself into the global economy, Cuba may use its strategic advantages in tourism and telecommunications to provide the lead. Emulating China, the island could begin to promote private enterprise in small-scale agriculture, manufacturing, commerce and transport, while allowing greater private participation in the service sector. The Chinese leadership has also shown sophistication and pragmatism in developing its relations with the United States. Beijing adopted a long-term view of the way it wished to work with Washington, while keeping attention focused on its important development objectives.

Still, the Chinese economy continues to suffer from structural problems that Cuba should rigorously avoid. First among these is the endemic corruption that represents the Achilles' heel of the Chinese miracle. China's market socialism has failed to erect proper boundaries between official power and private markets, leaving the government unable to address corruption except by mobilizing the repressive instruments of the state. Before China started down the path of reform, corruption did occur, but party officials also restrained themselves to avoid a crackdown by party authorities. Official power could be withdrawn at the leadership's discretion, and civil servants were hesitant about overreaching and possibly losing their access to the system of perks and preferences. However, that level of discipline has broken down over the last decade, allowing corruption in China to soar to previously inconceivable levels. Despite its great potential, the Chinese model has significant cracks that Cuba's future leaders will ignore at their peril.

Vietnam: The Long Renovation

Vietnam's history has important parallels with that of Cuba: both countries embarked on chilly relations with the United States during the Cold War and became targets of sanctions that left them largely isolated from the world economy. Over the last decade, however, Vietnam has embarked on a process of economic modernization while Cuba remains mired in the past. While Vietnam's economic performance has not been as striking as China's, the country has clearly come a long way since the break-up of the Soviet Union. The reason lies in the economic renewal policy of Doi Moi, crafted by Vietnamese officials during a period of malaise in the mid 1980s, when the country faced high inflation, intermittent food shortages, and isolation from the West. During the subsequent process of economic reform, Vietnam dismantled cooperatives, allowed the creation of family farms, liberalized prices, and began to emphasize macroeconomic stability. Although Vietnam's progress was slowed by the financial crisis in East Asia in the late 1990s, growth in output and exports took off, with average annual increases in GDP ranging from five to nine percent in recent years.

Vietnam has pragmatically moved away from central planning and towards market economics, in part to sustain the one-party political system.

Vietnam is currently aiming for seven percent growth, and official realized foreign direct investment (FDI) is approximately $2 billion per year. Poverty has been reduced by half, food production has dramatically expanded, and social indicators have exceeded the levels reached under central planning. This economic boom has occurred even as Vietnam's Communist Party continues to strictly control political activity. Through its special brand of "market socialism," the government now seeks foreign investment, with the private sector accounting for an increasing share of total output and nearly 90 percent of all employment.

Vietnam has pragmatically moved away from central planning and towards market economics, in part to sustain the one-party political system. While this strategy has some relevance for Cuba, comparing the economic performance of the two countries also has its limitations. Cuba is a small island nation with a 75 percent urban population and a dilapidated rural sector, while Vietnam is a large, poor country with three-fifths of its population working as peasant farmers. Another important difference is that close to 80 percent of Cuba's labour force is in the public sector, compared to only 10 percent in Vietnam. Like China, Vietnam has also prioritized normal relations with the United States following the end of the U.S. embargo in 1994, and has since sought to forge a strong relationship with the Washington-based international financial institutions. This contrasts sharply with the Cuban government's well-known antagonism towards the United States, and it underlines the degree to which the island's leadership prizes politics over economics.

While the Vietnamese have sought to open to foreign direct investment and more directly engage the country's diaspora, Cuba fears that establishing a market economy could potentially result in an inflow of Miami-based expatriates who are hostile to the regime. The two governments thus face different constraints that will shape their economic policy choices. However, Vietnam's communist political structure, experience with centrally planned economics, and difficult historical relationship with the U.S. and the broader international community do make the country an illuminating case study. Vietnam's development trajectory over the last two decades suggests interesting possibilities for Cuba's economic revival.

Which Path for Cuba?

This review of market reform in a range of socialist and post-communist countries reveals that there is no one formula that will guarantee a successful transition for Cuba. Some of the lessons to be learned from the individual countries and regions are summarized in Table 1 (page 10). However, while each has established a unique path towards reform, several common lessons also emerge that will be useful to Cuba's future.

Without question, significant market-oriented reforms are required to enable centrally planned economies to recover and grow. This is a clear lesson from China and Vietnam, which remain communist states while achieving rates of economic growth that range from good to excellent. These growth rates did not take off until each country liberalized its economy in important ways. Even in Russia and Eastern Europe, the initial precipitous decline was followed by stabilization and a more recent return to growth, which would have been impossible under central planning. By contrast, Turkmenistan's poor performance illustrates the opposite end of the range, where resistance to capitalism—and reluctance to diminish state control—has kept the country's economy constrained by Soviet-era policies and practices.

While expanding the space for entrepreneurial activities, the central government must remain competent and powerful to design and implement economic policy. Countries with weak governments have typically not fared well during the transition period, allowing for the rise of corruption and political instability. In the case of Russia, for example, the temporary withering away of the state during much of the 1990s contributed significantly to the country's poor economic performance. In extreme cases, severe political unrest or even state failure can have a devastating impact on the economic welfare of a society. Tajikistan's civil war in the 1990s is the most tragic illustration of how state collapse undermines economic well-being.

Past experience has shown that gradualist and sequentialist economic strategies can play an important role. "Shock" strategies that generate fast change and rapid implementation have worked well in the Czech Republic and the Baltic states, among others, but gradualist and sequentialist strategies have achieved impressive rates of growth in China, Vietnam, and Uzbekistan. In the early 1990s, the "big bang" approach promoted the quick embrace of market-oriented reforms, but the results were decidedly mixed for many of the countries that rushed into privatization before the appropriate legal and economic mechanisms were in place. Not all institutions developed for central planning need to be destroyed and rebuilt; some can be reformed to more effectively regulate a market economy. However, this is a delicate balance that varies from country to country, and excessive gradualism carries high institutional risks that may hinder future economic recovery. Cuba has adopted only very modest and insufficient agricultural reforms and still has yet to authorize significant changes in non-agricultural enterprises outside the state sector. The experiences of other countries suggest that gradualism can provide a useful way to prod an economy forward, but cannot replace a more far-reaching reform strategy.

Transition countries are more likely to thrive when policymakers recognize that their nation's principal long-term economic resource is its people. Investing in the health and education of citizens is not just a good general idea; it is also good economics in the long term. The quality of China's work force is one of its assets, and the Cuban population has similar potential due to the significant state resources devoted to education and health care. The Czech Republic has become one of the most celebrated examples of post-communist economic orthodoxy, but the advanced education of the Czech people contributed to the country's positive performance. Even Russia has managed to maintain a significant commitment to its educational system, and Vietnam's level of educational attainment has risen dramatically in the period since Doi Moi was introduced. By contrast, the collapse in the educational and health system in the Central Asian Republics has severely undermined the economic potential of this region, and facilitated an over-reliance on natural resources in place of human capital. Access to education and physical well-being are important determinants in development throughout the world, and this is especially crucial for centrally planned economies that are opening up to market forces and attempting to compete in the global economy.

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Finally, communist countries can join and benefit from the international financial institutions (IFIs). The participation of the Soviet Union in the 1944 Bretton Woods conference ensured that communist countries could enjoy full membership in the market-oriented multilateral institutions of the International Monetary Fund and the World Bank. In fact, Cuba was a founding member of the IMF and World Bank, but later withdrew during the early years of the Castro government. Although Russia only joined these organizations as a post-communist country in 1992, during the Cold War countries as diverse as China, Hungary, Poland, and Romania all became members. A member since the mid-1950s, socialist Vietnam later spent nearly twenty years estranged from the IFIs before normalizing ties in the early 1990s, as part of its resumption of diplomatic relations with the United States. As a practical matter, the process of accession requires improving relations with the U.S. government, which has the power to veto membership in most multilateral financial institutions. Short of that, the information and analyses generated by these institutions and the knowledge of their staff can be resources that will facilitate Cuba's market transition and eventual membership in the IMF, World Bank, and Inter-American Development Bank. Even before lending becomes politically feasible, Cuba could benefit from technical exchanges, training and development, and an economic policy dialogue on the challenges facing Cuba's integration into the global system.

Conclusion

Cuba's future remains difficult to predict, but there is little doubt that the island's post-Castro leadership will wish to complete the economic recovery from the early 1990s and generate sufficient resources to improve the standard of living of its people. Throughout the developing world, economic growth is a critical element in ensuring political health, and Cuba is no exception. Hungary, Poland, the Czech Republic and other countries in Eastern Europe have succeeded in liberalizing their economies while changing their political structures. Even Russia has made great strides in escaping from the Soviet shadows. On the other end of the spectrum, countries as diverse as China, Vietnam and Uzbekistan have adopted a mix of successful market-oriented policies without changing their political systems, which are not too dissimilar from Cuba's. Cuba's economic future will be vastly better if the island's leaders move further along the path of substantial market reform.

Table 1. Economies in Transition: Selected Lessons for Cuba

Russia	Privatization must be carried out in a way that minimizes opportunities for asset-stripping and corruption. Effective monitoring and enforcement mechanisms should be in place before privatization begins. A chaotic legal environment may allow the nomenklatura of the old regime to cement its control over the country's economic resources. Assistance programs focused on the neediest citizens can help assure social stability and public support for transition; conversely, allowing investments in health, education, and pensions to collapse exacerbates the pain of transition.
Eastern Europe	Comprehensive banking reforms, including streamlining bankruptcy procedures and eliminating non-performing loans, are vital to the success of transition. Price liberalization should be total; partial price liberalization can spark inflation or hyperinflation, rendering remaining price controls useless. Countries with deeper economic linkages to Western markets fared the best during the transition period
Central Asia	Government competence and stability are more important than the speed or sequencing of reforms. Corrupt or inept governments, or political instability, can hamper any kind of transition. Initial conditions will have an important impact on the overall trajectory of reform. Local and non-governmental institutions can be formalized and used to distribute social assistance or build support for reforms.
China	Even a communist government needs to draw clear lines between political office and private markets, as market opening provides many more opportunities for bureaucratic corruption. Gradual economic reform can work, but only if it is well managed by a capable government. Comprehensive agricultural reform improves productivity and rural incomes.
Vietnam	A policy of internal economic reform, such as Vietnam's Doi Moi, can help facilitate subsequent integration into the world economy. Normalization of relations with the United States is a crucial requirement for full access to the resources of the Washington-based international financial institutions. Communist parties will enact market reforms while attempting to maintain the existing balance of political interests and ensure continued support for the government.

Table 2. Transition Countries: Key Indicators

Country	Population	GDP (Billions of U.S. Dollars)	GDP Per Capita (U.S. Dollars)	Mean GDP Growth 1995-2004	Trade Volume Growth (Millions of U.S. Dollars)	Primary Exports	Total External Debt (Billions of U.S. Dollars)	External Debt/ GDP
Cuba	11,250,000	32.4	$2,880	3.7%	7.5	1. Nickel 2. Sugar 3. Tobacco Products	13	39.2%
China	1,299,820,000	1,681.3	$1,290	8.6%	1,154.4	1. Clothing/Garments 2. Electrical Machinery 3. Yarn and Textiles	229	13.6%
Vietnam	83,120,000	45.4	$546	7.3%	56.7	1. Petroleum 2. Textiles and Garments 3. Marine Products	18	39.1%
Russia	143,974,000	581.4	$4,038	2.9%	285.5	1. Petroleum and Derivatives 2. Natural Gas 3. Machinery	211	36.3%
Kazakhstan	15,048,000	40.7	$2,708	4.7%	32.9	1. Oil/Gas Condensate 2. Base Metals 3. Refined Copper	32	79.4%
Kyrgyzstan	5,121,000	2.2	$431	4.2%	1.6	1. Cotton/Wool 2. Base and Precious Metals 3. Tobacco	2	95.2%
Tajikistan	6,300,000	2.1	$329	3.0%	2.2	1. Aluminum 2. Cotton 3. Electricity	1	38.6%
Turkmenistan	6,030,000	5.2	$864	7.3%	7.2	1. Natural Gas 2. Oil Products 3. Cotton	2.5*	55.5%*
Uzbekistan	25,910,000	10.3	$398	2.8%	7.4	1. Cotton 2. Gold 3. Energy Products	5	49.6%
Bulgaria	7,731,000	24.2	$3,126	1.9%	24.2	1. Clothing/Footwear 2. Iron and Steel 3. Other Metals	16	66.0%
Czech Republic	10,240,000	107.0	$10,450	2.5%	133.1	1. Machinery/ Transport Equipment 2. Intermediate Manufactures 3. Chemicals	45	41.7%
Hungary	10,030,000	100.3	$10,000	3.6%	114.2	1. Machinery and Equipment 2. Manufactures 3. Food/Beverages/ Tobacco	60	59.5%
Poland	38,183,000	242.2	$6,344	4.4%	164.3	1. Machinery/Transport Equipment 2. Manufactures 3. Food and Live Animals	108	44.7%
Slovakia	5,440,000	41.0	$7,550	4.3%	56.8	1. Vehicles 2. Machinery 3. Base Metals	22	53.2%

All data are for 2004 unless otherwise specified.

*2003

Sources: Economist Intelligence Unit: http://www.eiu.com

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