Both were driven by a cult of personality that becomes difficult to extend beyond the life of the person. And the sweeping repression so central to both dictatorships depends on an image of invincibility that is often undermined by the death of the leader. The reliance on foreign allies generally makes the dictatorship less tenable and the dependence on a command economy becomes unsustainable, particularly in the current Cuban context.

The expected death of Castroism becomes the ultimate irony and penalty of foisting upon a decent people a truncated Marxism-Stalinism, making endless appeals to personal sacrifice and metaphysical history, instead of governing through modest guidance and the presumption that human beings are quite capable of determining their own lives. □

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Perestroika Cubana

Raj M. Desai & Itzhak Goldberg

ON APRIL 21, 2007, *Granma*, the official newspaper of the Cuban Communist Party released photos of a convalescing Fidel Castro meeting with a senior member of the Politburo of the Chinese Communist Party. The photos underscored how tightly Cuba has hitched itself to the Chinese economic wagon, and how much both Fidel and his brother Raúl have warmed to a country whose former leader, Deng Xiaoping, Fidel once described as a *mentecato* ("numbskull").

After Cuba lost its main benefactor, the Soviet Union, its economy shrank by over 35 percent. But Cuba has recovered, and more recently, with a little help from its new friends Venezuela and China—Venezuela subsidizes Cuba's oil consumption while China provides Cuba with investment and durable goods, and buys its sugar and nickel—Cuba has avoided the regime change that occurred when East European socialist states faced similar economic crises in the late 1980s. In Cuba, housing shortages, mounting debt and deteriorating public services have produced no mass protests, no general strikes, no throngs taking to the Plaza de la Revolución to demand multiparty elections or an end to central planning. Indeed, it now seems possible that Cuba may follow the "Chinese model" of reform, whereby Communist Party control is maintained alongside a gradual establishment of free-market incentives.

But can Cuba continue along this path?

Let us assume, for the moment, that the Cuban regime finds itself—in some not-too-distant future—without the Castro brothers and newly headed by reformers from within the Communist Party, as did the Soviet Union in 1985 when Gorbachev became the leader of the USSR. The question that Cuba will face then, as did the USSR in 1985, is: What kind of reform is possible?

Chinese advisors—already in place—will tell the Cuban government to avoid drastic changes to their enterprises. The Chinese will remind Cuba what the Soviet republics went through—hyperinflation, skyrocketing unemployment, widespread corruption and asset theft, widening inequality, banking crises, currency collapse and massive social disruption. They will explain that, instead, it is better to do what China did: To "grow" its way out of the problem by combining some price and trade liberalization, an environment for new businesses to flourish and strict public control over state enterprises. But they will be giving the Cubans a false choice. It was not China's "gradualism", but rather its unique economic structure that allowed China to reform without suffering economic dislocations. Likewise, it was not Russia's reform speed, but its over-industrialization that led to its economic collapse.

Cuba's economy—which resembles that of the smaller East European countries at the outset of their transitions far more than it does China—is a poor candidate for Chinese-style gradualism. Ultimately, Cuban prosperity must come from the revival its private sector through rapid reform.

FOR ALMOST a decade, the China–post-Soviet contrast has been misleadingly used to demonstrate the supposed advantages of incremental reform—"crossing the river while feeling the stones" in Deng's memorable phrase—over economic "shock therapy" or the "big-bang" approaches used in Eastern Europe and Russia. In a nutshell, the argument is that, in contrast to the post-Soviet and East European recessions in the 1990s, China succeeded not only in growing rapidly, but in creating a vibrant, non-state-owned enterprise sector at the same time.

But there are three well-known (and fundamental) flaws with the comparison of China and the economies of Eastern Europe and the former Soviet Union. First, a vibrant private sector emerged in China because, prior to 1978, China was a peasant, agricultural society in which the migration of workers from low-wage, low-productivity agricultural sectors to higher-productivity industry was relatively smooth.[1] In 1978, over 85 percent of the Chinese workforce was employed in agriculture. Although that proportion has shrunk by half in the intervening 29 years, surplus agricultural labor continues to flow to jobs in the steadily growing Chinese economy. By contrast, Soviet labor was primarily employed in heavy industry, restricting the availability of surplus labor flows into a "new" private sector.

Second, because of the economic structure of the post-socialist European economies, radical reform was a necessity, not a free choice. One forgets that Hungary and Poland both tried to avoid a harsh break with their socialist past through their own versions of gradual reform in the 1980s, to little avail. In both countries throughout the 1980s, the "non-state" sector expanded significantly, yet job creation and economic growth did not follow. Instead, these partial reforms became little more than a way for managers and employees to strip their companies bare. Finally, it should also be remembered that governments in Bulgaria, Romania, Slovakia and Ukraine all at-

[1]Jeffrey Sachs and Wing Thye Woo, "Understanding the Reform Experiences of China, Eastern Europe and Russia", *Journal of Comparative Economics*, Vol. 18, No. 3 (1994), pp. 74–88..

tempted their own versions of gradualism after 1990 that, in all cases, pushed these countries deeper into economic crisis.

Finally, Chinese reformers did not choose gradualism purely because it was an optimal reform strategy. Rather, a series of stalemates between hardliners and pragmatists following Mao's death, combined with the Chinese Communist Party's ideological commitment to public ownership, restricted the range of choices available to reformers.[2] To assume that reformers everywhere are free to choose a reform path based purely on sound economic and technical judgments completely ignores the political realities that reformers face, including the internal power struggles in which they are involved, the need to compromise and the need to secure a minimum degree of public support.

And Cuba shares much more in common with the smaller East European countries in 1990 than with China in 1978.

As of 2005, just 20 percent of the Cuban workforce is employed in agriculture. That compares closely to the situations in Ukraine (22 percent), Poland (23 percent), Bulgaria (25 percent) and Lithuania (20 percent) almost two decades ago. Cuba's share of labor in industry (22 percent) also compares to Ukraine's (26 percent), Moldova's (20 percent) and Lithuania's (29 percent).

The service sector in Cuba is dominated by tourism. Since these workers already receive certain benefits—wages paid in dollars or in convertible pesos along with additional, unofficial income—they will stay tied to that sector. This leaves laborers in industrial state enterprises to fill the labor-force void—precisely the same "available" workers that forced smaller East European nations to adopt rapid privatization and enterprise-restructuring reforms in order to facilitate the migration of these employees to the new private sector.

It is notoriously difficult to lure workers, capital and productive inputs from the state sector to the private sector, as long as the former remain heavily subsidized. State-enterprise employees in centrally planned economies, of course, benefit from a whole host of "social assets" that are funneled through their workplaces, such as health clinics. Cuban state enterprises continue to offer job security, guaranteed income, health care and housing through their places of employment, creating strong disincentives for relocation to the private sector.

So, unlike in China, where large numbers of peasants left agricultural collectives that did not provide that level of social protection to work in the emerging private sector, it is highly unlikely that Cuba will be able to rely on the type of workforce flows from subsistence agriculture that have been the source of China's long expansion.

A post-Castro government may find it tempting to maintain state ownership in order to avoid unemployment or social unrest. But Cuba will not be able to rely on the good graces of state-enterprise managers, particularly if the Cuban party–state apparatus begins to fray. Indeed, there is evidence that some spontaneous privatization has already been underway since Cuba's main benefactor, the Soviet Union, collapsed.

In the 1990s Cuba experimented with various private-sector reforms, in particular, the establishment of joint ventures with foreign investors, the conversion of state enterprises into joint-stock corporations (*sociedades anónimas*) and a reduction in budgetary subsidies.[3] Many of the corporations created out of these private-sector reforms, for example, have be-

[2]Barry J. Naughton. *Growing Out of the Plan: Chinese Economic Reform, 1978–1993* (Cambridge: Cambridge University Press, 1995)

[3]Philip Peters, "State Enterprise Reform in Cuba" (Arlington, VA: Lexington Institute, 2001).

come profit-sharing arrangements for the Cuban equivalent of the *nomenklatura*, the *pinchos grandes* who, as with their East European counterparts, have occasionally used their position to engage in similar theft and corruption.

Whether a reformist Cuban government might embrace a voucher system leading to "mass" privatization is not clear. Several East European and former Soviet countries, facing the task of changing ownership in large numbers of companies, turned to mass privatization through the free distribution of vouchers to the public—vouchers that could be exchanged for shares in state enterprises. After the voucher scheme seemed to work in Czechoslovakia and Russia, voucher privatization was enthusiastically embraced by both reformers and external advisors, and by the mid-1990s it was the privatization method of choice in 17 East European and former Soviet nations. Proponents of mass privatization hoped that the profit incentives unleashed would soon revive faltering, centrally planned economies. That revival didn't happen.

Instead, groups of insiders, speculators and fly-by-night investors managed to grab most of the shares in these firms, usually by exploiting the fact that capital markets were unregulated in most countries and that most voucher-holding citizens were unprepared to be shareholders. So, investment funds began offering "deals" to convince citizens to sell their vouchers for cash, and by the mid-1990s, had acquired controlling interests in most voucher-privatized companies. Lacking oversight and regulation, many of these investors (along with enterprise managers) enriched themselves by diverting cash flows and assets, while leaving worthless, debt-ridden shells for other shareholders.

A voucher program in Cuba would, very likely, suffer a similar fate, creating a coterie of well-connected investors able to grow rich(er) quickly by exploiting disorganized and ill-informed shareholders, fueling resentments and frustration among ordinary citizens. Although many of these programs did succeed on a number of fronts—e.g., the Czech program quickly transferred ownership over 1,600 companies to private hands and removed government from the tricky business of industrial restructuring—the opportunities for pilfering and self-dealing suggest that voucher-based programs should be avoided.

Much more contentious will be the need to resolve expropriation claims in a manner that does not interfere with Cuba's economic reforms. Potential hold-ups in the settlement of these claims can derail Cuba's efforts to revive its economy, since private investors are unlikely to put money into entities that have unclear titles, outstanding claims or other liens on their assets. In Eastern Europe, restitution claims tended to place heavy burdens on weak judicial systems and often held up enterprise reforms where enterprise facilities were located on land subject to restitution claims. Privatizing nationalized companies by restoring ownership to pre-Castro owners would involve similar problems on a far grander scale.

Moreover, these claims will remain a roadblock to the normalization of U.S.-Cuba relations unless they are effectively and quickly resolved. As of 2002, there were approximately 6,000 claims by U.S. nationals totaling \$6.8 billion (about 25 percent of Cuba's GDP). A number of alternatives to direct restitution have been proposed, and a joint acceptance of any of these increases the likelihood of an embargo lift: A negotiated lump-sum payment from Cuba to the United States on behalf of U.S.-based claimants may hold the most promise.

A reforming Cuban government, of course, would find it impossible to pay out anything close to the total owed. But if similar settlements between the United States and East European nations are taken as precedent, the resulting agreement would be less than 100 percent of the net present value and would not include interest, making some repayments possible.

BUT COULD a post-Castro government make reform work? Loss-making companies, even after they have been privatized, have several ways of avoiding financial discipline. They obtain cheap loans from state-owned banks. They stop paying taxes. Or they stop paying bills to suppliers—especially utility and power companies. These suppliers, in turn, have their own reasons to avoid their own bills, and sometimes even stop wage payments. These never-ending chains of debt can be broken if these entities lose their open access to public finances. In technical language, the first step in reviving the private sector is to "harden budget constraints." This means eliminating the flow of public funds to persistently loss-making enterprises, cutting off banking credits and creating a level financial playing field with regard to taxes, customs duties, environmental regulations, licenses, permits and fines.

By far the trickiest part of private-sector reform in socialist economies involves transforming state enterprises from (usually) inefficient and unproductive entities into engines of a new economy. Many of the lessons from the East European transitions in the 1990s were effectively applied to the last country in the region to undergo significant reforms: Yugoslavia—Serbia and Montenegro, in particular. As with other East European nations, private-sector reform proved to be contentious, riven by factionalism and politically charged. The Serbian economy also faced the risks of asset degradation, theft and corruption that were found elsewhere. Yet privatization in Serbia was remarkably smooth and has not led to large increases in unemployment or industrial unrest. As with Cuba, many Serbian firms were actually structured as workers' cooperatives rather than "state enterprises."

Restructuring in Serbia did not mean that loss-making companies were bailed out, but rather that the company would "gear up" for privatization by separating its good from its bad parts, selling the former and liquidating the latter. The Serbian government put together a list of firms, all of which were loss-making, but that were thought to contain salvageable assets. A typical firm then underwent "segmentation." This process divided core and non-core assets and likely viable units from those more apt to falter. It provided for the incorporation of new companies from salvaged parts of the old and the sale of the rest through competitive auction. Although it may make little sense to restructure companies that are bound to fail, since governments will almost always try to resuscitate those that cannot be sold, better then, to make their liquidation politically palatable.

Obviously, governments are also extremely reluctant to bankrupt companies that are un-sellable. Rather, they let ill-equipped courts deal with these matters, often clogging up the judicial system and preventing other, newer companies from scooping up the usable land and equipment. East European countries that managed bankruptcy well (Poland, Slovenia, Lithuania) resisted the temptation to rely too heavily on the courts, instead establishing special agencies or governmental units that could initiate bankruptcy proceedings against companies that continued to receive subsidies, but had not undergone restructuring by a certain deadline.

Finally, one of the mistakes made in East European reforming economies was that, following privatization, many reformers assumed that capital markets would take care of themselves. Consider the contrast between the Czech Republic and Poland. Czech Prime Minister

Vaclav Klaus refused to establish a regulatory body for the securities exchange, fearing it would bring capital markets to a standstill. In 1997, following a series of corporate scandals, he finally relented and established a securities regulator. In Poland, on the other hand, rules for a securities commission were put in place during privatization. As a result, Poland avoided the asset theft and expropriation that was common in the Czech case.

ALL OF this may end up being speculation. There are few signs that Cuba will seek lessons from Eastern Europe, rather than Chinese, economic history anytime soon. China's post-Mao accomplishments in reforming its economy under single-party rule continue to impress and influence the current Cuban leadership. Fidel himself has called China "the most promising hope and best example for all the countries of the Third World."[4] Meanwhile, as Sino-Cuban economic and political relationships have expanded, Russia's ties with its former ally have foundered over issues such as the resolution of Cuba's Soviet-era debt and the closure of Russia's famous listening post in Cuba, the Lourdes signals-intelligence facility. Cuba's ties with Eastern Europe have fared worse. Former leaders Vaclav Havel, Arpad Göncz and Lech Walesa have been at the forefront of an international movement to support Cuban dissidents. Moreover, the new East European members of the enlarged EU have taken a hard line against any changes in the common stance towards Cuba, effectively freezing the EU's Cuba policy.

There are, of course, some possible events that might push Cuba to embrace rapid reforms—a precipitous fall in commodity prices, or a renewed fiscal crisis that forces the government to reduce food subsidies, or the collapse of critical economic sectors. These events are unlikely, and whether they would unleash large-scale protests is uncertain. Closer ties with Venezuela and China have kept Cuba's economy growing and its fiscal and current account deficits small.

But Cuba will find that following its Chinese (or Venezuelan) benefactor will not lead very far. The gradualist reforms pursued by China are simply ill-suited for an island nation of eleven million inhabitants with a relatively small agricultural sector, located a half-hour's flight from the world's largest economy. Without rapidly reforming its inefficient state enterprises, Cuba will face the prospect of becoming trapped in a low-wage, low-productivity cycle. While little is likely to change under Raúl Castro, sooner or later Cuba will have to look away from the Chinese model and embrace some of the lessons from East European reformers. □

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[4]Quoted in William T. Ratliff, "Raul, China, and Post-Fidel Cuba", *Latin Business Chronicle*, August 28, 2006.