

# From Planning to Market: A Framework for Cuba

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The measures introduced by Raúl Castro since 2008 and the most recent US–Cuba policy change indicate that Cuba is shifting from a planned and highly centralised state socialist economic model toward one in which economic actors and markets become main drivers of the economy. The examples of Asian and Central and Eastern European socialist countries suggest four distinguished pathways for such transition. The question is which one may provide a feasible model for Cuba. Based on the country's economic and population structure, this study places the Cuban case within the framework of socialist economic transitions and explores some policy implications.

Keywords: Asia, Central and Eastern Europe, central planning, Cuba, market economy, socialist transition.

What is the most feasible and least bumpy way for Cuba to move from a centrally planned socialist economy to a post-command model in which markets play an increasingly important role? Should Cuba implement an Eastern European or Vietnamese-type shock therapy, or should the island follow the state-controlled Chinese model to gradually build an economy where production, distribution, pricing and investment decisions are made by autonomous private actors?

The *actualización* (update) introduced by Raúl Castro to 'update socialism' and the new era of the US–Cuba relationship suggest economic changes in Cuba. Although some restrictions still apply, now it is much easier for American citizens to travel to Cuba, use their credit cards and take back souvenirs, including alcohol or tobacco. Despite these signs of a move from a strict planned state socialist economy toward a market driven economic model the general picture is still puzzling. Privatisation of state enterprises is definitely ruled out and the state insists strict control over most important areas (Feinberg, 2014).

Some fundamental social and economic organisations were strikingly similar in all state socialist systems during the classical stage of socialism (Kornai, 1992; Szelényi, 2008). The classical socialist model with strong and direct state ownership and firm control of the centrally-planned economy is still the fundamental element of state organisation in Cuba (Backer, 2013). The current status of Cuba, as one of the last bastions of

centrally planned socialism in the world, is similar to other socialist countries' situation in the 1970s and 1980s when they implemented their first economic reforms. Therefore, comparing contemporary Cuba with other socialist countries is a legitimate strategy to assess the Cuban case and develop scenarios.

The Asian and the Central and Eastern European (CEE) socialist systems followed two fundamentally different directions from planning to market: Socialist stated-controlled transition in Asia and rapid dual, political and economic changes in CEE. Raúl Castro stated several times that he would be interested in Sino-Vietnamese-style state-controlled economic change (Yamaoka, 2009). The question is whether these two Asian countries would really provide a feasible model for Cuba. In order to answer this question here we compare the main socialist pathways from planning and market and evaluate their relevance for Cuba.

The organisation of the paper will be as follows. First we briefly discuss Cuba's current economic situation a few years after President Raúl Castro's economic reforms. Then we provide a framework for socialist transition and discuss the main pathways from planning to market. Based on five major internal and external factors that determined the outcome of these transitions, the third part places the Cuban case within this framework. Finally, we provide some policy recommendations.

## Cuba after Raúl Castro's Economic Reforms

Although Raúl Castro's attempts to update socialism have resulted in some positive economic effects, they seem to be far less comprehensive than reforms implemented in China in the 1980s or Vietnam in the 1990s (Miranda-Parrondo, 2014). The primary goal of the 2008 policy was to significantly expand the non-state or private sector. The most important measures were the reactivation of self-employed labour, the authorisation to buy or sell cars and real estate, and the possibility to get access to bank credits. Moreover, about 170,000 private farmers were authorised to sell their products to Cubans and tourists. The government announced the release of 500,000 public employees from the state payroll. New policies were also introduced stimulating small enterprises to absorb large numbers of these laid-off state sector workers. These include easier rental of facilities, increase the number of permitted activities to 181, raise of the seat limit in restaurants from 12 to 20, and allowing imported inputs at wholesale prices (Ritter, 2014). In 2011, additional measures were announced such as the permission to hire up to five workers in all self-employed categories, expansion of restaurant capacity to 50 seats and provision of some micro credits to enterprises.

The outcome of the reforms, however, is rather puzzling. Small private entrepreneurs are still punished with high tax rates and many state producers have guaranteed quasi-monopolistic position in the market (Estrada, 2014; Ritter, 2014). Cuba has large fiscal and merchandise trade deficits and massive foreign debt in hard currency with additional low productivity and low efficiency (Spadoni, 2014: 5). The economic organisation of the state still suggests a rigid centrally planned system, controlled and managed by state-level authorities. The decision-making autonomy of state enterprises is reduced to a minimum and provincial and municipal governments have almost no authority over economic management in their territories (Estrada, 2014). To sum up, the market is controlled but not regulated by the state.

The orthodox communist ideological framework of the *Partido Comunista de Cuba* (PCC, Cuban Communist Party) also limits the government's recent reform attempts

(Backer, 2014). In 2014, out of 178 countries, Cuba was ranked 177th on the Economic Freedom Index that evaluates basic institutions protecting the liberty of individuals to pursue their own economic interests. Only North Korea received a lower score on this index. The Regulatory Quality (RQ) indicator, published by the World Bank, reflects a government's ability to formulate and implement sound policies and regulations that permit and promote private sector development. Based on its RQ score Cuba was ranked 202nd of the 210 evaluated countries in 2013. Since the Cuban economy is still based on a planned socialist system, analysing other socialist cases is essential to draw some lessons for the country.

## **Pathways from Planning to Market**

Some economic features such as the centrally planned economy and the soft budget constraint were quite similar in all state socialist systems during the classical stage of socialism. Soft budget constraint suggests that for socialist firms there was no particular danger in running loss or advantage in making a profit, and therefore, they were not motivated to be efficient because they survived anyway (Kornai, 1998). These companies did not have a strong interest in the quick and flexible adaptation of the supply and demand conditions that were significantly different from the planned demand calculated by state bureaucrats (Van Brabant, 1990).

By the 1970s, however, the task of centrally directing the national economy without the use of prices in resource allocation became increasingly difficult within the classical socialist framework (Balassa, 1970). Industrial output and agricultural production faltered and most socialist countries faced crucial economic problems (Kornai, 1959). In centrally planned systems, the huge gaps between the unrealistic targets and actual performance required frequent modification of the plan. Most Soviet bloc countries had to introduce some forms of reform. China in the 1970s and Vietnam in the 1980s faced famines that triggered even more radical economic liberalisation (Thalemann, 1996; Yamaoka, 2007). Due to different social and economic factors communist countries followed different pathways from planning to market. Most of these factors were related to the countries' structural arrangements and some external impacts. In fact, not only two but four pathways can be distinguished in Asia and CEE, though the outcomes of such patterns were also different. The four ideal-typical models discussed in this study are (a) China, (b) Vietnam, (c) Eastern Europe (Russia), and (d) Central Europe (Poland and Hungary). Table 1 shows the key factors influenced the transition from planning to market in socialist countries.

### *Centralised vs. Decentralised Socialist Economies in CEE*

Reform attempts in the 1960s and 1970s sought to provide varying levels of economic independence to socialist enterprises. The Soviet Union and other Eastern European countries such as Czechoslovakia, East Germany, Bulgaria, Ukraine and Romania introduced rather minor economic adjustments and remained strict centrally planned states by the time when the Eastern European communist systems collapsed in the late 1980s. Although some reforms began in Russia in 1985 when Gorbachev came to power, their nature was mainly political rather than economic (Boone and Fedorov, 1997). At the same time, countries in Central Europe such as Poland and Hungary (also Yugoslavia in Southeast Europe) had a relatively decentralised economy with significant private

**Table 1.** From Planning to Market (Key Factors)

	Initial conditions during socialism (1970s–1980s)			Pathways from planning to market				Market economy	
	Economic structure under socialism	Reforms under socialism	Key reform actors under socialism	Market liberalisation	State's role in the changes	Driving forces of changes	Privatisation	Transformation crisis	Economic performance
China	Agricultural	Decentralised economy	Bottom-up & top-down	Gradual	Strong socialist state	Bottom-up & top-down	No mass privatisation	No crisis	Good
Vietnam	Agricultural	Decentralised economy	Bottom-up & top-down	Rapid & radical	Strong socialist state	Bottom-up & top-down	No mass privatisation	No crisis	Good
Central Europe	Urban & over-industrialised	Decentralised economy	Bottom-up & top-down	Rapid & radical	Weak state	Top-down	Large-scale and quick	Crisis but quick recovery	Mixed
Eastern Europe	Urban & over-industrialised	Centralised economy	No	Rapid & radical	Weak state	Top-down	Large-scale and quick	Prolonged crisis	Bad
Cuba 2015	Urban but de-industrialised	Centralised economy	No	Limited	Strong	Top-down	?	?	?

entrepreneurial activities (Gupta, 1980; Lin, 1995; Zukowski, 1996). In reform-socialist countries (China, Vietnam, Poland and Hungary) first so called 'local markets' emerged. Within these basic markets usually food and services were produced and exchanged by peasants and workers (Szelényi and Kostello, 1996). During this period, the revenues of the least educated people rose. Although bottom-up social forces, small entrepreneurs and peasants played a substantial role in the changes and reform processes, the capital and the labour force were still allocated by redistributive means (Nee, 1989; Kemény, 1990; Szelényi, 2008). During the late 1980s, in the more advanced 'socialist mixed economy' phase, market and redistributive mechanisms went hand-in-hand (Szelényi and Kostello, 1996). This time, new and better-educated actors emerged in such markets and created more sophisticated and innovative enterprises. The market started to obtain the allocation of capital and labour from the communist redistributive system.

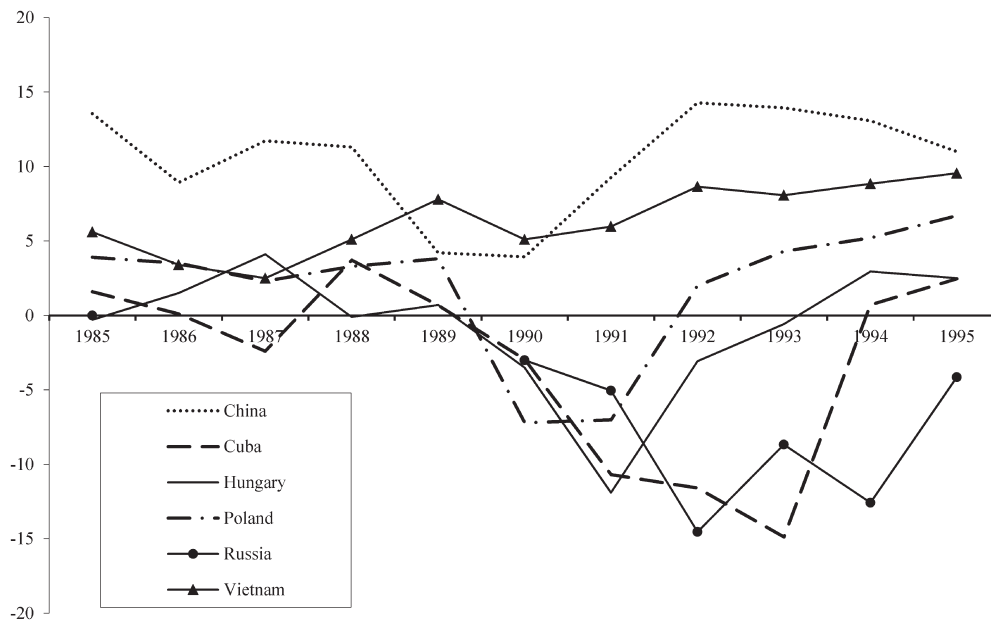
The unexpected collapse of state socialism in Central and Eastern Europe between 1989 and 1991 was followed by a dual transition from a centrally planned economy to a market economy, and from an authoritarian single-party regime to fully or partially democratic parliamentary systems. Reflecting the speed and the significance of these changes, the literature often calls this immediate shift from socialist economic system to market economy a 'big bang' process. Another consequence of the rapid system collapse is that the strong centralised state system disappeared overnight and the actual economic transition occurred within a newly emerging weak political institutional structure.

### *Gradual vs. Rapid Economic Reforms in Asia*

The most important difference between the Asian and the Central Eastern European models of transition is that the communist party remained in a monopolistic political position in China and Vietnam, while the communist system collapsed in CEE. Therefore, in Asia the economic transformation was entirely controlled by a powerful socialist state. Similarly to Central European countries, China and Vietnam built a 'socialist mixed economy' by the early 1990s. In both Asian socialist countries the reforms started in the agriculture sector. China and Vietnam liberalised prices and thus facilitated the growth of the private sector, opened their economy for FDI, and imposed hard budget constraint on SOEs and exposed them to domestic and international competition (Irvin, 1995; Bai, Jiangyong and Zhigang, 2006). However, contrary to popular belief, real marketisation in Vietnam was not made by a step-by-step gradual process but was the result of a radical structural adjustment and stabilisation program in 1989 (Riedel and Comer, 1997). Vietnam has decollectivised its agriculture relatively quickly and, in many respects, has embarked upon a reform program that has moved much faster and further than China's similar economic reforms (Watts, 1998). As the gradual reform strategy implemented in 1986–1988 failed to address serious macro-economic imbalances, in 1989, Vietnam enacted an Eastern-Europe style big bang, including price liberalisation, a 450 percent devaluation to unify the exchange market and sharply tightened credit policy and collective farms were returned to family farms with long term leases (Dollar, 1996). In the mid-1980s, Vietnam (as well as Cuba) was heavily dependent on Soviet subsidies and was isolated from international trade. This is probably an important factor to why Vietnam had to implement radical changes when the Soviet Union stopped supporting the country. After 1990, the Vietnamese economy accelerated at an unprecedented high rate (Brundenius and Le Dang, 2014).

In contrast to Vietnam, where reforms were implemented rapidly, China's reforms were undertaken gradually in different stages after Deng's political hegemony in 1978

Figure 1. GDP Annual Percentage Growth 1985–1995.



Source: World Bank.

(Sachs et al., 1994). The slow deregulation in China was based on a dual track prices system, first implemented in the agricultural sector between 1978 and 1984, while the industrial sector remained under central planning management (Cao, Fan and Woo, 1997). This allowed the government to control economic development while calming down inflation since prices were slowly adjusted to the increasing demand. Moreover, China gradually opened its non-strategic sectors to FDI in order to support knowledge spillovers. Another important difference between China and Vietnam is that the former was not linked to the Soviet bloc and thus did not suffer from its collapse.

### Outcomes of Marketisation

While CEE countries faced sequences of severe socioeconomic crises, China and Vietnam emerged mainly unscratched from the marketisation process (Szelényi, 2013). The speed of market liberalisation does not seem to be a crucial explanatory factor for this outcome, both Vietnamese shock therapy and gradual Chinese implementation of reforms led to good transitional economic performance. Figure 1 shows the differences in economic performance of socialist countries between 1985 and 1995.

The scale and the pace of the transformation of entire political systems and the shift from wholly publicly owned into full private ownership in both Central and Eastern Europe is unprecedented in recent human history. Yet, societies in the region paid heavy price for this ‘big bang’ (Kornai, 1993). The newly emerged capitalist system was followed by increasing social inequalities. The massive de-industrialisation eliminated most industrial and agricultural jobs and people in these sectors became permanently unemployed because they could not transform their skills to be fit for the new post-industrial capitalist environment (Szelényi, 2013). The economy’s output fell by 20–50 percent in the region (Szelényi, 1998). Many scholars blame the rapid mass



privatisation, recommended by Western advisors, for the crisis. Empirical findings suggest that the closer a given country's policies approximated the neoliberal goal of mass privatisation, the worse its subsequent economic performance (Hamm, Lawrence and Stuckler, 2012). The possible reason for this is that privatisation eliminated profits of state-owned enterprises as a source of state revenue. It also created enterprises lacking strategic owners. Declining state capacity – fiscally and bureaucratically – promoted corruption and weak institutions.

Output prices were immediately collapsed by unrestrained competition from West European farmers (Baukó and Gurzó, 2001; Lerman, Csaki and Feder, 2004). Agricultural input prices skyrocketed due to deregulation of the prices of fuel and fertilisers (Borzutzky and Kranidis, 2005). The poverty rate jumped significantly and life expectancy declined substantially in the CEE region (Szelényi, 2013). However, the recession in Russia and other post-Soviet Eastern European countries was deeper and lasted longer than in Central Europe where, many scholars believe, early economic reforms and the relatively large group of entrepreneurs helped to resist more serious transformation shocks (Swaan and Lissowska, 1992; Zukowski, 1996; Smallbone and Welter, 2001). This 'pretransition market microfoundation' softened the impacts of the transformation crisis (Cruz and Seleny, 2002). Such bottom-up socialist entrepreneurs were also the engines of marketisation in China and Vietnam (Nee and Opper, 2012).

## **Where Does the Cuban Case Fit?**

The economic structure of socialist countries influenced their pathways from planned to market economies and the main outcomes of the transition. This section discusses five dimensions of socialist economies during the pre-1990 period and compares them with contemporary Cuba. The data presented here are based on the authors' calculations. It is hard to find reliable statistical information on socialist countries from the 1980s. Therefore, we have merged data from different sources even within one table. Some cases are still missing. Due to a lack of comprehensive data, we used aggregate average score for the period between 1970 and 1990 and between 2010 and 2014.

### *Sectoral Differences*

In Asia, reforms started in the agrarian sector, which was the main engine of the growth during the early reform period. Compared to China and Vietnam, the CEE bloc was overindustrialised by the 1970s, leading to the dominance of heavy industry over agriculture and light industry, consumer goods and services. The labour force is one of the crucial factors of production and economic growth. Due to their underdeveloped state sector during the first stage of the transformation from planning to market, China and Vietnam were able to transfer workers out of the low-productivity agricultural sector to the non-state sector without having to tackle the large problems that continue to exist in the state industrial sector (Sachs et al., 1994). In fact, this easy movement of low-productivity, rural and non-state-sector workers to higher-productivity (e.g., township and village enterprises) activities was the primary engine of the Chinese and Vietnamese growth during the early phase of the reforms (Cao et al., 1997). Moreover in Asia, the low level of industrial concentration and decentralised self-sufficient regional economies made the emerging market systems relatively competitive and resilient (Cai and Treisman, 2006). In contrast to the Sino-Vietnamese model, in most CEE economies

**Table 2.** Socialist Economic Structure in Communist Countries

		Aggregate data 1980–1990						Aggregate data 2010–2014
		China	Cuba	Hungary	Poland	USSR	Vietnam	Cuba
Net output of a sector (value added % of GDP)	Industry	43.9	18.8	47.4	–	–	27.4	20.5
	Service	24.1	68.1	–	–	32.5	32.5	74.5
	Agriculture	31.2	13.1	–	–	16.8	41.4	5
Employment in a sector (% of total employment)	Industry	19.5	–	39.0	38.0	29.3	–	17
	Services	14.9	–	37.1	33.0	21.1	–	65
	Agriculture	65.6	–	21.7	27.9	22.2	–	18.5
Employment in organizations (% of total employment)	State enterprise	18.2	–	70.75	70.5	93.1	–	78
	Collective	81.3	–	24.4	16	6	–	4.29
	Private	0.4	–	4.7	13.4	0.9	–	17

Source: Library of Congress, 1989; Sachs et al., 1994; Oficina Nacional de Estadísticas (ONE); ILO; World Bank.

the complex and sophisticated division of labour constituted a more heterogeneous workforce. Here the industrial sector was extremely large, and there was no hope of starting a significant private sector without restructuring the whole industry (Sachs et al., 1994).

Table 2 shows a relatively insignificant agrarian sector in Cuba, which currently provides only 5 percent of the GDP and less than 20 percent of the workforce. Of 6.3 million ha of agricultural land only 2.6 million ha are being cultivated (Feinberg, 2014). Sugar production in 2011, once the Cuban agriculture’s leading industry, was at 16.4 percent of the country’s 1989 figure (Miranda-Parrondo, 2014). As Table 2 shows, the proportion of Cuban agrarian employees is even lower than it was in CEE in the pre-1990s period. This suggests that Cuba cannot replicate the model of Asian agricultural growth (Vidal, 2012). While, similarly to the CEE before the transition, currently about 78 percent of Cuban workers are employed in the centralised state enterprise sector, only 18.2 percent of the Chinese labour force worked in this sector during the pre-1990s period. Moreover, while the Asian model suggests large-scale decentralisation in the agricultural sector, food production in Cuba is still highly centralised. According to an official Cuban publication (Ministry of Foreign Commerce and Investment, 2014) the entire food industry is controlled by three large state-owned holding companies: GEIA, CUBARON and CORALSA. While the government would welcome foreign partners to invest in pork, poultry and citrus or shrimp production, the sugar industry will remain under strict state control (Feinberg, 2014).

Cuban industry is in a bad shape too. Since 1990, the manufacturing sector has experienced lack of capital, shortages of raw materials and technologically outdated machinery and equipment (Mesa-Lago and Pérez-López, 2013: 41). Due to the hard-currency availability constraint, Cuba relies on expensive imports of raw materials, essential inputs for manufacturing. Moreover, old and less energy-efficient technology, the legacy of Soviet times, is still heavily used in the country making production expensive. In 2011, the output of the manufacturing sector was 55 percent lower than the 1989 level.

The huge dominance of public sector employment makes it hard for the emergence of a Cuban non-state sector. In the case of market liberalisation in Cuba, workers in



the highly subsidised state-sector will be reluctant to move to a newly emerging private sector because of higher uncertainty, less benefits and high taxes. Although the wages in the public sector are relatively low, employment is guaranteed, working hours are limited, and workers have free health care and are able to participate in a social security retirement system (Boggs and Thale, 2012). Additionally, there is little incentive to make significant efforts in the private sector since people do not have to work too hard at their public sector jobs for these benefits (*The Economist*, 2012). Despite the government's determination to channel people from the state to the market sector, in 2011 only 17 percent of the workers having been granted private licences were actually coming from the state sector. Most of these new entrepreneurs were people from the black market or outside the labour force (Brundenius and Le Dang, 2014).

In China and Vietnam, the non-state sector grew rapidly due to the very low salaries in subsistence agriculture (Sachs et al., 1994). There, the new sector developed without dismantling the public sector while in the CEE the private sector emerged through massive privatisation of state assets. For Cuba, it will be also difficult to create a significant private sector without 'collapsing' the state sector, but mass privatisation is definitely not part of the official Cuban agenda. In the CEE, a very high proportion of public employees who suddenly lost their jobs in 1989 and 1990 became inactive and disappeared from the labour market forever (Szelényi, 2013). It happened despite the facts that the whole economy was liberalised, foreign companies were more welcomed and establishing enterprises was free in any sectors. The case of the CEE suggests that many of those who would be fired from the socialist state sector in Cuba will not be active participants in the private labour market. The relatively small private sector can absorb a fraction of fired workers, but mainly in low-level service jobs (Sagebien and Betancourt, 2014).

### *Entrepreneurship*

As Table 2 shows, in the CEE, before the fall of the communist system, a large number of public sector employees worked in industry while in contemporary Cuba industrial employment represents only 17 percent of the workforce and two-thirds of the workforce are employed in the service sector. During the 1980s and early 1990s, there was extensive entrepreneurial activity in Central Europe and Asia that provided a strong precondition for the effective transition from planning to market. Compared to other socialist countries, the Cuban private sector employs a relatively high proportion of workers, about 17 percent (see Table 2). Yet, most of them are in the service sector and such activities do not represent too complex business models. In fact, they are not linked to productive value chains (Sweig, 2013; Brundenius and Le Dang, 2014). People who newly became self-employed are typically leasing state installations such as barber shops, beauty shops, taxis or land (Peters, 2012). In 2011, only 7 percent of new Cuban entrepreneurs had college degrees while 40 percent of them had ninth grade or even lower education level (Peters, 2012). At the same time, 16 percent of the total labour force hold university degrees (Brundenius and Le Dang, 2014). This suggests that Cuba is in the *local market* phase of economic transition when least-educated small entrepreneurs and self-employed people are most active in the small emerging private sector (Szelényi and Kostello, 1996). Highly qualified people such as doctors and lawyers do not have the chance to acquire entrepreneur skills because these professionals are banned from starting private practices. They are only allowed to work in the public sector (Ritter, 2014). Entrepreneurship that leads real economic development in a country must be innovative and cannot be achieved by low-level service activities.

Table 3. Population Structure in Communist Countries

		Aggregate data 1980–1990						Aggregate data 2010–2014
		China	Cuba	Hungary	Poland	USSR	Vietnam	Cuba
Urbanisation	Urban population (% of total)	18.7	64.8	62.4	55.6	66.7	18.8	75.3
Population age groups	Ages 0–14 (% of total)	35.5	31.9	21.1	24.9	23.0	41.0	16.8
	Ages 15–64 (% of total)	59.6	60.6	66.2	65.6	67.6	53.7	70.4
	Ages 65+ (% of total)	5.0	7.5	12.7	9.6	9.4	5.3	12.9

Source: Oficina Nacional de Estadísticas (ONE); UN Statistics Division; World Bank.

### *Export-Led Growth*

The private sector, mainly entrepreneurs running small shops in Cuba, will definitely not boost exports. The public sector does not produce goods that might be the basis of a Sino-Vietnamese development model nor does Cuba have a CEE-style export-oriented development model. The goods sector (agriculture, livestock, fishing, mining and manufacturing) represented only 19.1 percent of the Cuban GDP in 2011 while the service sector provided the remaining 80.9 percent (Mesa-Lago and Pérez-López, 2013: 31). The service sector and remittances make up the bulk of the country's GDP and apart from health-care goods, there are no products Cuba may export. The proportion of employment in services significantly exceeds the contemporary international levels and the skills that service sector employees developed cannot be easily applied to production of goods and services (Pérez, 2014). In fact, the Cuban economy has become a low-productivity service economy with domestically consumed output where merchandise export counts for less than 10 percent of the national output (Feinberg, 2012; Mesa-Lago and Pérez-López, 2013: 33). In 2013, the value of Cuban exports was \$5.5 billion. In contrast, Hungary, a similar size country, had a total export value of \$9.1 billion in 1986 and in 2013, the Hungarian export reached \$108 billion, suggesting how small Cuba's export sector is (UN Comtrade). Although Cuban export of medicines, vaccines and other pharmaceutical goods rose notably after 2003, this growth has been almost entirely driven by the rise of sales with Venezuela (Spadoni, 2014: 21). Cuba is also in the group of Latin American countries with the fewest preferential trade agreements (Cordovi and Pérez, 2014).

### *Population Structure*

Cuba, similar to the socialist CEE countries, was already highly urbanised in the 1980s. As Table 3 shows, the level of Cuban urbanisation further increased by the 2010s. Currently, 75 percent of the population lives in urban areas. In contrast, China and Vietnam were mainly rural countries in the pre-1990s period, where less than 20 percent of the population lived in cities and towns. This also confirms that an Asian agriculture-led take off is not a feasible solution for Cuba. Since there is a very low chance for re-ruralisation of Cubans, the country needs an economic model relying on a high-level of urban workforce.

**Table 4.** Cuban Working Age Population 2006–2013

	2006		2013	
	Number	%	Number	%
15–39 years	4,307,348	58.4	3,700,119	51.3
40–59 years	3,069,732	41.6	3,514,559	48.7
Total working age (15–59)	7,377,080	100	7,214,678	100

Source: Oficina Nacional de Estadísticas (ONE).

A society with a falling birth rate and a high proportion of young adults entering the labour market has a huge potential to create more products than other countries without this demographic bonus. However, this ‘window’ exists only for a few decades. The advantageous age structure between 1970 and 1990 substantially accounted for the economic miracle in Asia (Bloom and Finlay, 2009). Table 3 indicates that Cuba had similar population structure in the pre-1990s period, however, current data imply that the country will not be able to use this one-time opportunity to boost its economy as Asian socialist countries did. Although in contemporary Cuba the percentage of working-age adults is very high, 70.4 percent, the internal structure of this population suggests that Cuba will enjoy this labour force advantage only for a few more years. In fact, China has also fully realised this demographic benefit and will face soon an economic slowdown (Babones, 2015). As Table 4 shows, between 2006 and 2013, the percentage of younger Cuban adults (aged 15–39) within the working age population dropped by over 7.1 percentage points.

Although with the new maximum age of retirement (65 for males and 60 for females), introduced in 2008 (Cordovi and Pérez, 2014), the government has bought some time, the general tendency suggests a rapidly aging workforce and rising number of people entering the non-active group of the population. This demographic structure means that the country’s workforce started to shrink and elderly care costs will significantly rise in the very near future. Moreover, as the case of CEE countries suggests, successful retraining and adaptation for market sector conditions are more challenging for older than younger adults. This indicates that a high proportion of aging employees fired from the state sector will become rather inactive even if they are still in the working age category.

### *International Factors*

The collapse of the COMECON market had a huge contribution in the transformation crisis in the CEE. States and economic actors had to adapt to the new environment and implement a radical geopolitical reorientation almost overnight. The rapid political and economic changes generated a sudden shock in industries where actors, protected by subsidies and trade tariffs, were not ready to face the strong competition of powerful, efficient and well-capitalised Western actors. Currently, Cuba’s economic isolation is even higher than the CEE countries had before the system collapse. Table 5 shows that during the 1970s and 1980s, within the communist bloc, Cuba was the least export-oriented country. It had only 30 export partners while Hungary had around 130 and Poland had more than 110 partnering countries. At the same time, the number of countries where

**Table 5.** Number of Export Partners (Countries or Territories)

	Poland	Hungary	Cuba	Vietnam	USSR/Russia	China
1970	–	127	–	76	–	–
1975	–	125	30	–	–	–
1980	116	138	31	–	–	–
1985	103	133	–	–	–	167
1990	116	135	–	–	–	180
1995	160	171	–	–	–	201
2000	165	178	106	181	175	204
2005	206	184	119	205	174	208

Source: UN Comtrade.

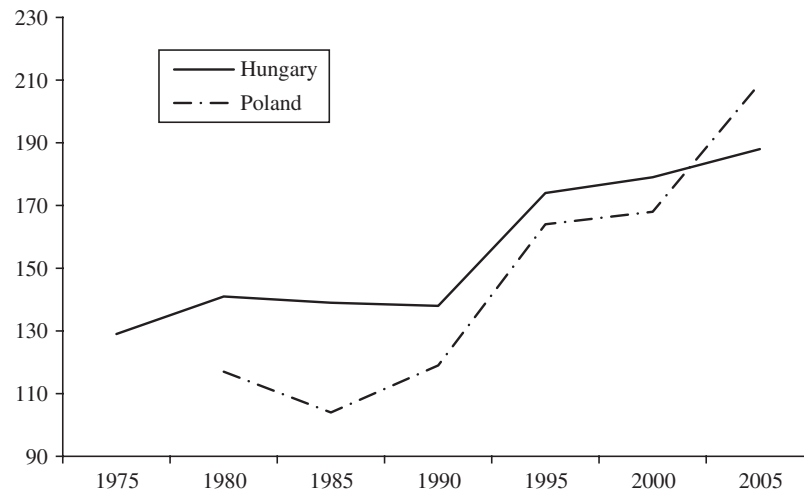
China exported goods exceeded 150. According to the latest available UN Comtrade data, Cuba had 119 export partners in 2005.

Cuba's trade dependency on Venezuela and China makes the country vulnerable in a scenario of an economic meltdown. Venezuela's oil was worth more than \$3.6 billion to the Cuban government in 2014 (Toro, 2015). If Cuba had to pay market price for the imported Venezuelan oil, this would have an unpredictably dramatic impact on the country's economy. The late 2014 crash in oil prices has devastated Venezuela's already troubled economy, indicating that Caracas will not be able to continue providing cheap oil to Cuba (Krauze, 2015). Under new circumstances, only dramatic economic opening to other countries could prevent a serious social and political crisis in Cuba that could risk the socialist government's stability.

Cuba's geographic proximity to the US market is of a strategic advantage. In this sense, Cuba is better located than China, Vietnam or Russia to reintegrate into global markets. Central European countries had the same closeness advantage to another huge economy: the European Union (EU). The accession to economic and monetary union (measured separately from other national-level developments) significantly contributed to economic growth of the CEE countries (Rapacki and Próchniak, 2009). Even the first stages of association – bilateral trade and cooperation agreements, which provided for trade liberalisation in the associated countries in exchange for financial aid by the EU and technical assistance to the transition process – accelerated significant growth in the region (Monastiriotis, Kallioras and Petrakos, 2014). Figure 2 shows that immediately following the collapse of the communist system in 1989–1990 Hungary and Poland significantly increased their number of trading partners. This suggests that recent normalisation of the relations with the United States may be a great economic opportunity for Cuba (Pérez, 2012).

Despite the announced structural reforms, investment in Cuba has been way below the planned level since 2009 (Vidal and Werner, 2014). The new Foreign Investment Law, introduced in early 2014, offers more favourable terms to foreign investors than the previous 1995 law. It allows investment in all economic sectors (except public health, education and armed forces), cuts the tax on profit from 30 to 15 percent and eliminates the 25 percent tax on labour costs. However, two major obstacles to FDI were left untouched: any foreign investment must be approved through a lengthy process by state authorities and investors need to hire expensive labour from government agencies, rather than hiring workers directly. This significantly limits the companies' control over personnel, skills and incentive structures.

Figure 2. Number of Export Partners of Poland and Hungary 1970–2005.



Source: UN Comtrade.

The Cuban government's constant attempt since the late 1990s to create China-style independent Free Trade Zones (FTZ) to boost exports has failed because Cuban authorities have not let economic activities be driven by market forces (Willmore, 2000). For example, they introduced a hidden taxation related to hiring Cuban labour. Since Cuban authorities designed a very similar tax regime, the heaviest labour tax in the world, for the newly opened Mariel Export Processing Zone, the future success of this project is also uncertain (Feinberg, 2012; Ritter, 2013). Without two crucial incentives, cheap labour and unrestricted access to the huge US market, the Cuban FTZ attempt will probably fail.

## Areas with 'Take-Off' Potential

Bottom-up socialist entrepreneurs were the engines of the marketisation in China and Vietnam and helped to resist more serious socioeconomic disaster in Central Europe. However, the Cuban service sector with an unsophisticated entrepreneurial structure will not be able to lead such a transformation. There are no bottom-up social agents who could create private markets where a significant amount of capital is accumulated and allocated. Cuba cannot build a socialist mixed economy without a vital private sector. The absence of this important precondition also suggests that Cuba cannot launch a rapid marketisation process because there are no noteworthy economic actors who would drive such changes or buffer the impacts of a possible transformation shock. Most importantly, the country needs to create a market sector that is able to obtain the allocation of capital and labour from the centralised redistributive system. For this, the economic reform process should shift from local market-phase to a more advanced socialist mixed economy where well-educated and innovative actors play a significant role. Cuba has a well-educated labour force but the country has failed to take advantage of its huge investment in education (Brundenius and Le Dang, 2014). Self-employment is limited to 181 occupation categories and most of them are low-level service jobs (Sweig, 2013). As a first step, Cuban authorities should lift this barrier and allow highly qualified people to start private practice. As Tables 6 shows, Cuba is way behind Latin America in

Table 6. Indicators of ICT Infrastructure

	Cuba	Latin America
Fixed telephone lines (/100 pop.)	10.6	18.5
Mobile telephone lines (/100 pop.)	11.7	106.7
Internet users (/100 pop.)	23.2	39.4
Broadband internet subscriptions (/100 pop.)	0.04	7.5

Source: (Cordovi and Pérez, 2014).

terms of information technology infrastructure, a crucial factor of entrepreneurship in the twenty-first century. For example, how can a thriving private tourist sector exist with limited internet access? This requires investment in infrastructure, equipment, as well as education and training.

The aging Cuban workforce alone would be a crucial challenge for Cuban policy makers. With the possible radical restructuring of the public sector, however, the early exit of these employees may increase inequality and social tension on the island. It may also put strong pressure on the health care and pension systems. Managing this growing subgroup within the working-age population requires a fundamental change in official human-resource strategies. The main goal should be to prevent the early exit. Techniques implemented by other countries such as training, development and flexible working practices provide useful examples for Cuban policy makers.

Perhaps, the most important lesson of post-socialist transitions for Cuba is that system collapse and uncontrolled big bang will probably result in a brutal transformation crisis. The Cuban state must control the route from planning to market, and must introduce hard budget constraints and real market conditions in more spheres of economic life. Decentralisation is also a key factor. Even if the party keeps its political power administratively and economically, the country should be decentralised. Companies cannot be managed through centralised administrative measures. They need wide-ranging autonomy to respond faster to market incentives. Currently, tourism is the only sector that might be the engine of a quick take off and medium-term growth by providing the badly needed hard-currency earnings (Feinberg, 2014). From the 1990s, the sector experienced an unprecedented growth in terms of visitor arrivals, revenue generated by tourism and tourism infrastructure (Hingtgen et al., 2015). Despite the positive visitation trends, however, poor food and relatively expensive service contribute to one of the lowest return rates in the travel business (Sharpley and Knight, 2009). The island is also highly dependent on a few key markets such as Canada, the United Kingdom, Spain and Italy. If Cuba wants to exploit the opportunities offered by a potential thaw in US–Cuban relations, significant improvements will be required in terms of the quality, value and diversity of the island’s tourism product. Nevertheless, a prosperous tourist sector requires twenty-first-century infrastructure including roads, airports, railway stations, communication networks and so on. Therefore, Cuba should allow foreign actors to invest in large-scale infrastructure projects on the island.

Cuba should follow a gradual state-controlled transformation from planning to market, but an Asian-type agriculture-led economic growth model does not seem to be a feasible option for the country. Due to several factors such as the relatively small size of the agricultural sector, the level of urbanisation, the highly centralised economic organisation and the high level of state employment, there is a little chance that the agricultural



sector would be the engine of economic growth. The country's economy needs to shift from the current local-market phase to a more advanced socialist mixed economy that requires better educated and more innovative and sophisticated private entrepreneurs. For that, the government should give highly qualified people the opportunity to run a private business and acquire entrepreneur skills. Moreover, beyond tourism and the pharmaceutical industry, Cuba should identify export products that are internationally competitive.

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