

TRANSITION IN CENTRAL AND EASTERN EUROPE: LESSONS FOR DEVELOPMENT OF SMEs IN CUBA

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The experience gained from the extraordinary process of transition, still under way in Central and Eastern Europe and in the former Soviet Union, is rich with lessons that could guide policy making and action in a Cuba of the future. This presentation attempts to distill some of these lessons and to explore those which would facilitate the growth of small and medium-size enterprises, the so-called SMEs, when transition finally unfolds in the island.

Ten years after the initiation of transition in the former command economies of Central and Eastern Europe (CEE) and the Former Soviet Union (FSU), one thing is certain: the process of transformation is far more complex and it takes far more time and resources than envisioned in 1989. The reason is that transition involves changing institutions, practices, and behaviors that have taken root in society during decades of centralized control and political repression. Another certainty is that it is possible to transform economic and political systems radically and end up with market economies and political democracies. Ten years after the Berlin Wall fell, most production in countries in transition originates in the private sector and is transacted under free market conditions. In addition, most of the people live under democratic rule, where the people can vote governments out of office and have done so.

OVERVIEW OF CHANGES IN CEE AND THE FSU

The decision to change came about at different times in different countries in the region. In fact, Hungary, Poland, and Yugoslavia had already started some re-

forms by the late 1980s, before the destruction of the Wall. In 1990, COMECON, the Soviet-dominated free trade area, was dissolved as members decided to start trading in hard currency and at world market prices. The disappearance of the Soviet Union, where Gorbachev had started a re-structuring program under socialism, witnessed in 1992 the start of transition in Russia and the newly independent Baltic states.

How do we define transition? In this context, transition has been the process of transforming what were non-democratic regimes, whose economic systems were centrally-controlled by the government, and where the state owned most of the means of production. The major objective of transition, at the national level, has been to develop an economic and political system that stimulates sustainable economic development and increased national wellbeing, in a context of political freedom. The move toward a private-sector based economy operating in a market context has been a key aspect of transition. Another, equally important aspect has been the move toward representative democracy.

The modus operandi of the former socialist countries in their transformation has required a number of key policy changes. To successfully divest the state of the elements used to control and to increase efficiency, most of the region's countries undertook programs of liberalization to free prices, privatization and distribution of the ownership of the means of production into private hands. In addition, the countries initiated stabilization programs that called for monetary

and fiscal discipline. These stabilization programs provided the foundation for the development of financial systems that worked in market prices, and dealt with productive enterprises on the basis of their creditworthiness rather than by public subsidization. The introduction of hard budget constraints and the privatization of large firms have been, in fact, two of the most essential but also most difficult undertakings. In many of these countries this process has not been completed and has not been perfect.

A second group of changes has dealt with development of the institutional structures and processes required to support a market system and private property. Aside from developing adequate financial systems, these efforts have included the development and adoption of an appropriate legal framework and legal institutions to address, inter alia, property rights, contractual dispute adjudication, the rules for commercial transactions, and a financial regulatory framework.

Finally, and in parallel with these changes, transition has meant the development of representative, participatory democracy. This undertaking has required the development of legal rules that protect and stimulate the creation of institutions of civil society including political parties, and that prescribe periodic competitive elections.

In terms of the objectives referred to earlier, experience indicates that, generally, CEE and FSU countries have ended up into two groups.

- Most progress has been achieved in the countries of Central Europe, such as Hungary, the Czech Republic, Slovenia, Slovakia, Poland, and the Baltic countries. These are, in fact the countries that historically have had greater contact and linkages with Western Europe. This group rapidly implemented liberalization and has undertaken sustained — though sometimes controversial — stabilization programs. These, in turn, have provided the foundation for institutional change. Two powerful forces have helped. One has been the role of citizens in newly adopted representative democratic systems. The other the

tantalizing prospect of joining the European Union and NATO.

- The slow achievers, such as Belarus, Ukraine, Russia, Moldova, have been laggard in implementing liberalization programs or in mounting steady stabilization programs. In these countries, progress towards truly representative democracy has also been slow. In many, the former political elites remain powerful and unwilling to relinquish control. A great deal of rent-seeking behavior remains. As a result, markets have been less efficient, soft-budget constraints remain, and the environment for private firms has been less than ideal. Many obstacles, as well as corruption, remain and impede the growth of new private firms.

WHAT ARE THE KEY LESSONS OF THE LAST TEN YEARS?

A number of important lessons can be learned from the transition experiences of CEE and the FSU:

- The faster the liberalization and stabilization programs are put in place the easier they are to implement.
- Democratization must proceed apace in order to empower the people and weaken the former *nomenklatura* who would oppose change. To the maximum extent, the old guard must be dispossessed of power.
- Political competition is as important a factor as is market competition to assuring a sustainable transition.
- The state must assume an infinitely less controlling role than before. Yet, it must remain strong and credible to help create and support the conditions and the institutions required by a market system.
- Institutional restructuring must be implemented as rapidly as possible so that the legal, financial and regulatory frameworks are in place. Otherwise, growth of SMEs would be severely constrained.

- The transition program must have the support of the population on the whole, a fact that suggests all groups should bear equally the necessary costs of transition. Special attention must be given to programs that assure this outcome.
- The possibility of joining a successful, read rich, trading group constitutes a major incentive to undertake rapid change. Further, external alliances can encourage and facilitate change.
- There will be serious declines in output, particularly in large state-owned firms. These are also difficult to sell off before they are restructured.
- Privatization can be achieved in many ways. One is selling large state enterprises. Another is selling or transferring property of small firms to their current employees. The third way is creating the right conditions for new small and medium sized firms to appear.

WHY SMEs?

SMEs deserve the interest they have received in transition countries for three fundamental reasons: First, they are employment intensive. Second, when managed by the owner, they have proven to be efficient. And third, they are a very effective means of deepening the privatization process by making thousands of citizens private entrepreneurs with a stake in the new system. In fact, SMEs are considered to be one of the principal forces underlying transition in CEE.

SMEs play a large role in developed economies. For example, according to the United Nations Economic Commission for Europe, in 1995, 99.8 per cent of enterprises in 19 countries in Western Europe were SMEs; 92 per cent of the total number of these were firms with fewer than ten employees. In the United States, small businesses employ more than half of the labor force; in 1994, the Small Business Administration reported that of about 22 million non-primary firms in the United States, 99 per cent were small.

SMEs are attractive because of their agility in adapting to changing market and supply environments, their role in deepening managerial and entrepreneurial skills, their employment intensiveness, and their contribution to diversity and competition in the sup-

ply of products and services. Similar experiences have been observed in transition countries where agricultural lands have been transferred or sold to former rural workers.

As has been the case in the United States, many of the faster transition countries have organized institutions to stimulate growth of SMEs. The Czech Republic, Hungary, Poland, the Baltic countries, Slovenia, Slovakia, and even slower-moving Romania have all created institutions and implemented programs to assist SMEs.

PRE-TRANSITION CUBA

Cuba remains a country with an economic system closely patterned after that of the former Soviet Union, pre-Gorbachev.

- Most economic and all political decisions are made at the top.
- With few exceptions affecting a minute portion of output, all domestic prices are administered.
- In addition to the national currency, the U.S. dollar circulates legally. The official peso/U.S. dollar exchange rate has no relation to the shadow price of the national currency. A large variety of important basic needs goods can only be purchased in dollars. This dual currency system has created an acute gap between the level of living of those who have dollars and those who do not.
- The state owns the large majority of productive enterprises and most of the agricultural land. Private SMEs are prohibited and politically rejected.
- With the exception of individual work performed by a small group of licensed self-employed, the state is the only legal employer.
- Structure, level, price, and distribution patterns of output are decided administratively.
- Budget policy is directed at maintaining current institutional structure underwriting with subsidies most state enterprises, including agricultural ones.

- The tax system is rudimentary and it is used, explicitly, not to produce revenue but to control and repress those authorized to work on their own. In practice, only the self-employed pay income taxes.
- There are no standard accounting procedures nor transparency in governance.
- The political system is also closed. Political parties, other than the Communist Party, are not permitted.
- Elections which do take place are not competitive. All candidates to parliament are selected by the Party. The parliament seldom debates bills and meets only several days per year to ratify government decisions.
- There is no civil society to speak of. Dissidents and opponents are persecuted and frequently jailed.
- No experience in participatory democracy and citizens independent action for the last two generations.
- Known but unmeasured environmental damage from past government programs and human survivalist behavior.
- Prevalence of obsolete and fuel-intensive technology.
- Outstanding claims of former property owners on a large number of confiscated properties.
- Total inadequacy of current financial system to serve the needs of citizens, entrepreneurs, and SMEs.

ASSESSING FACTORS TO HELP TRANSITION

The preceding elements suggest the challenges and difficulties Cuba will face as it decides on transition. Cuba must reckon with both its assets and its liabilities.

Cuba's important assets are:

- A highly educated population, with technical skills that, though frequently not up to date, will likely allow rapid learning. Infusion of new productive technology could quickly lead to large increases in productivity and production.
- A good stock of natural resources that can be used to advantage.
- A large near-by exiled population with substantial know-how and capital, eager to assist.
- Geographical closeness to largest market on earth. In medium term, good prospect of joining the North American Free Trade Agreement (NAFTA)

Cuba's liabilities are:

- A mindset bred after 40 years of experience that leads to a high degree of avoidance of risk and individual decision making. Fear.

SEQUENCE FOR DECISIONS

The diverse experience in transition cases in Europe suggests that Cuba will have to move rapidly on a number of fronts to ensure success of transition reforms. Short-term liberalization and a massive stabilization program should be quickly put in place with help from the international financial institutions (IFIs). Their financial support will also be required to organize and implement programs to minimize welfare impact of dislocations brought about by restructuring. Acute inequalities must be avoided. This assistance from the IFIs is also needed to make available the technical expertise required to develop and support structural reform programs.

Particularly in view of the past 50 years of repressive regimes, Cuba must move decisively to restore representative democracy. The population must share responsibility and agree with the overall direction of reform.

A modern and fair tax system will be necessary so that the government can raise revenues to develop physical, financial, and human infrastructure to support the market and the private sector.

Government should move rapidly to privatize small state firms. Such a move would make economic sense and help generate popular support for reforms. There are probably few claims from former owners on these group of firms.

Special, non-subsidized, programs must be developed to stimulate investment in new SMEs. These firms would have a large short term impact on employment, output and the diversity of supply. They would provide employment for those workers let go from inefficient state-owned large firms, thus facilitating, in turn, their privatization.

It will also be of the utmost urgency to attempt and solve the issue of claims on property confiscated by the Revolution. The issue has been handled in different ways in the CEE. Some countries have effected some restitution to former owners. Others have approved compensation in diverse ways. Still a third group has not recognized any claims. The important thing in Cuba is not to let it linger without a legal, and hopefully just, decision. Undue delays will affect the political stability of a new transition regime and effectively impede the reform process and act as a drag on domestic and foreign investment.

ROLE OF THE OVERSEAS COMMUNITY

The Cuban overseas community can and, I believe, will be a major constructive factor in supporting transition in Cuba. Tens of thousands of Cubans in exile represent a reservoir of knowledge, experience,

know-how and networks in a variety of fields — including a familiarity with modern technology — that could make an invaluable contribution to national recovery. In addition, there are substantial quantities of overseas Cuban capital that can fuel investment in a wide range of businesses.

Further, overseas Cubans have actively taken advantage of the opportunities to participate in the U.S. political process. This involvement and the political networks developed will be very helpful in making the case for economic assistance and eventually for Cuba's integration into the NAFTA.

The transition process needs to create a sufficient forward momentum that it may be guided but not reversed by the ups and downs of an open political system. International experience with what works is now very solid. We collectively know what needs to be done: taking advantage of participatory democracy and transparency to educate the population on the needs for transition and what will be done to minimize its costs is the responsibility of all, economists, technicians, and politicians. Without the informed support of the majority of the people, sustained transformation of Cuban society will not occur.