

**CUBA**

**GOVERNANCE AND SOCIAL JUSTICE**

**CUBA'S TRANSITION: LESSONS FROM OTHER  
COUNTRIES**

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## GOVERNANCE AND SOCIAL JUSTICE

### CUBA'S TRANSITION: LESSON FROM OTHER COUNTRIES

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## **Part I: Introduction**

### Purpose

As is well known, Cuba has outstanding social indicators, far superior to most countries in Latin America. It is also recognized that Cuba may face, at some point, a transition to a more market based economy and a more open system of governance. Experiences in countries that have made or are in the process of making that transition may be of interest in seeing a successful transition in Cuba if and when the time comes. The purpose of this paper is therefore to identify and to help anticipate the challenges that Cuba might face in the transition, based on the experiences of other countries. The goal is to focus on the challenges that Cuba could face, avoid pitfalls, mitigate potential negative effects and enhance positive opportunities in the process.

### Relevant Experiences

The paper endeavors to identify experiences relevant to the future quality and extent of social justice and governance in Cuba. Of particular importance is preserving Cuba's achievements in health and education. Another area is maintaining an equitable distribution of income and productive assets and the affordability of basic public services. At the same time, the pernicious effects of this transformation on the demand and remuneration of labor may lead to unemployment and falls in real wages, generating the need for more robust programs of social protection and assistance for the vulnerable. There may also be effects on political institutions, the quality of public services, justice and the level of corruption. Greater inequality and poverty can lead to social tensions and there may be a rise in crime and other harmful behaviors, aggravating racial/ethnic and gender relations, and undermining social inclusion. Finally, countries in transition were not alone and received considerable support from international organizations and civil society. These experiences, too, indicate the kind of support that Cuba might receive.

Cuba's experience would no doubt be unique. Nonetheless, a number of countries can offer lessons, both positive and negative experiences. Most of these cases cited in this paper are from the former Soviet block and COMECON countries that have been transforming their economies and institutions for the past fifteen years. Among these countries, there is a diversity of experience. Generally, Eastern European countries closest to Western Europe, such as Hungary and Poland, represent the best cases for Cuba to emulate: these countries have fared better and recovered faster than Russia and members of the Commonwealth of Independent States (CIS). Eastern European countries have also been significantly more able to preserve equality within their populations and they have prevented large pockets of severe poverty from forming. Furthermore, from the point of view of institutions and social conditions, the starting countries in Eastern Europe may more in common with Cuba. On the other hand, experiences of countries that made up the former USSR and Yugoslavia may be less relevant. One reason is that most of these countries were satellites or provinces. Thus, they lacked their own institutions, such as central banks, and were overly integrated thus making their transition

more complex. Moreover, Russia, due to its size and complexity, and the rest of the CIS, with low levels of economic and institutional development, are less comparable to Cuba. As a result, preference was given to examples from Eastern South and Central Europe. The experience of Vietnam, a country along with China pursuing successfully economic liberalization without a concomitant political transformation, is cited only once.

Many examples are offered from countries in Latin America that have common characteristics with Cuba and share many of the same problems. It must be remembered that many countries in Latin America only reverted to democracy during the 1980s, after periods of military, authoritarian rule. Most examples have been drawn from one of the best overall performers, Chile which has been able to cut poverty by half during the 1990s. Other examples are drawn from Colombia, Costa Rica, Argentina, Nicaragua, Guatemala and El Salvador, in particular sectors where the experiences of these countries may be relevant both from the point of view of what worked and what did not work.

### Structure

The paper is divided into five sections, in addition to the introduction. The following section (Part II) summarizes Cuba's achievements and the challenges that it will likely face. The next section (Part III) addresses each of the identified challenges, providing examples of what other countries have done. The circumstances in these countries, their starting conditions, how they have faced the challenges, the impacts, and how this might be relevant for Cuba are described. The specific areas addressed are:

- Land restitution, de-collectivization housing, and property rights
- Subsidies and affordable housing and basic public services
- Wages, labor dislocation, pensions and social protection
- Access and quality of health and education
- Political institutions, rule of law, and anti-corruption
- Decommunization, social capital, and inclusion

The next section (Part IV) highlights the role of institutions—both foreign and local-- and civil society in affecting these changes and the final section (Part V) provides a brief summary of the lessons. The key lessons are presented in Annex 1 and background sources and references are listed in Annex 2.

## **Part II: Cuba's Achievements and Challenges<sup>1</sup>**

### Measuring Development Progress

There are numerous studies and statistics that document Cuba's achievements over the past forty years. The intent of this section is to highlight the achievements that need to be preserved, to identify the stresses that Cuba already faces or may face in the future, and to anticipate the policy choices that might have to make. A starting point for

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<sup>1</sup> References and sources used in this section are presented in Annex 2.

assessing social progress is the Millennium Development Goals (MDGs), the uniform criteria applied among developing countries.<sup>2</sup> In almost all of these, Cuba stands out, as shown in Box 1. It performs better in terms of social indicators and less well on measures of environment and global partnerships.

**Box 1: Meeting the Millennium Development Goals**

**1. Eradicate extreme poverty and hunger:**

Extreme poverty and hunger have likely been eradicated in Cuba. However, since the fall of the USSR, caloric intake declined, in some cases below the required level. The government responded by increasing food supply and there has been considerable recovery of caloric intake.

**2. Achieve universal primary education**

This goal is essentially achieved in Cuba.

**3. Promote gender equality**

The equality of girls in education is achieved. The proportion of woman in the national parliament is above ¼. It should be noted that Cuban woman have not historically figured highly in politics or in the public sector.

**4. Reduce child mortality**

Cuba has made good progress on child and infant mortality. From 1990 to 2002, both fell by more than a third, generally to levels similar to those of developed countries. Cuba has met the immunization goal.

**5. Improve maternal health**

Maternal mortality ratio is still relatively high, albeit much better than most of its comparators. The rate has increased, probably due to economic stress within the family and botched abortions. The goal of attendance of skilled staff at birth s fully achieved.

**6. Combat HIV/AIDS, malaria, etc.**

Detailed information is sketchy, but Cuba is generally doing well on all of these.

**7. Ensure environmental sustainability**

Increases nationally protected land areas from 17 percent in 1995 to 67 percent in 2002 do not appear reasonable. Cuba has serious environmental problems, especially soil erosion, polluting industry and trucks, use of leaded gasoline. Cuba had joined in on many international agreements and has adopted a sound environmental framework. However, it lacks the financial means to implement needed measures.

**8. Develop global partnership for development**

Cuba does not have reasonable reporting of unemployment rates. Phone access is low but increasing, as is access to personal computers. However, in early 2004, the government introduced regulations that require a foreign passport to use the Internet in public facilities.

Social Indicators

A look at more detailed statistics, see Table 1, shows that Cuba has achieved much in the social sectors in comparison to among the best performers in Latin America—Chile and Costa Rica; similar neighbors—El Salvador and Dominican

<sup>2</sup> See “World Development Indicators”, World Bank, 2003 and WDI online edition.

Republic; and the average of high income OECD members.<sup>3</sup> Cuba has attained universal access in primary education and educational outcomes, according to recent standardized international tests at the primary level (3<sup>rd</sup> and 4<sup>th</sup> grade mathematics and language), are vastly superior to that achieved by other 36 countries, including Chile, likely the best performer in Latin America.<sup>4</sup> Cuban students scored correctly more than 80 percent of the time, outperforming their comparators by a wide margin. Cuba is the only country in Latin America to have achieved near 100 percent enrollment in pre-school. Enrolment in secondary education (compulsory education to the age of 14) is also high, with about 80 of the school age population enrolled. Cuba has also been an innovator in rural and specialized education, teacher training and computers. A telling statistic is that illiteracy has fallen from 24 percent in 1953 to 4 percent as of 1981 and now stands at 3 percent of the total population. A distinctive features of the educational system is the number of hours of teaching per year --about 1,000 hours, closer to that of Japan and much more than most countries in Latin America ( in the range of 700 hours per year).

**Table 1: Selected Social Indicators (2000/2001)**

<b>Indicators</b>	<b>Cuba</b>	<b>Chile</b>	<b>Costa Rica</b>	<b>El Salvador</b>	<b>Dominican Republic</b>	<b>OECD Higher Income</b>
<b>Life Expectancy</b>	76.8	75.9	77.6	70.1	67.2	78.0
<b>Infant Mortality</b>	7.0	10.0	9.0	33.0	41.0	5.0
<b>Low-birth Weight</b>	8	5	6	11	14	Na
<b>Maternal Mortality</b>	24	33	35	180	110	Na
<b>Immunization Rate</b>	99	97	98	99	98	90-94
<b>Physicians per 1000</b>	5.2	1.1	0.9	0.9	1.5	3.0
<b>Adult AIDS Rate</b>	0.1	0.3	0.6	0.6	2.5	0.3
<b>Gross Primary Enrollment</b>	102	103	107	109	124	102
<b>GrossSecondary Enrollment</b>	85	75	60	54	59	106
<b>Primary Teacher Ratio</b>	10.7	31.4	24.9	25.6	40.5	17.0

Source: World Development Indicators, 2003

<sup>3</sup> See “World Development Indicators”, as above, along with “Human Development Indicators”, UNDP 2003; “Desarrolla Humano y Equidad en Cuba”, UNDP, 1999; and “Indicadores Sociales Basicos de la Subregion Norte de America Latina el el Caribe, CEPAL, editions 1998-1999 and 2002.

<sup>4</sup> See “Programmes that Work: Early Childhood Development”, The State of the World’s Children, UNICEF, 2001; “The Cuban Education System: Lessons and Dilemmas” by Lavinia Gasperini, World Bank, December 1999; “ Cuba’s Social Services: A Review of Education, Health and Sanitation”, by Dan Erikson, et al, InterAmerican Dialogue, January 2002; and “Hacia Donde Va el Gastso Publico en Educacion: Logros y Desafios, Volumen III, Una Mirada Comparative”, by Antonio Sancho, et al, CEPA:, March 2001.

In the case of health, the results are equally impressive, especially on the side of lowering infant and maternal mortality rates, but also eradicating communicable diseases. Diseases such as measles, typhoid fever, tuberculosis, diphtheria, and tetanus have been eliminated or reduced dramatically.<sup>5</sup> Among other things, Cuba's AIDS rate is among the lowest in Latin America, and life expectancy, high. Eighty-eight percent of the adult population is reported to use contraception. As might be expected, Cuba's health profile has changed, reflecting its aging population and diseases associated with life-style, such as cancer, cirrhosis, heart problems, and sexually transmitted diseases.

It should be noted that Cuba started out well and that progress has not been even over the past forty-five years.<sup>6</sup> At the outset of the Revolution, Cuba already had strong social indicators as compared to the rest of Latin America. Data from CEPAL on infant mortality from 1950-55 put Cuba, with at a rate of 80 deaths per 1000 live births, among the best performers in Latin America, next to Martinique, Puerto Rico, Uruguay, Trinidad, and Argentina. World Development Indicators for 1960 show that Cuba outperformed most of Latin America in terms of infant mortality—39 deaths per 1000 live births, as compared to 102 for the region as a whole—and was not that far from the average for higher income OECD members (35 deaths per 1000 live births). At that same point, Argentina had 60 deaths and Chile, 107 deaths per 1000 live births. Thus, in relative terms, countries such as Chile have done better in reducing infant mortality.

Importantly, the last decade has been hard on the Cuban people. Cuba has seen a significant deterioration in income equality during the 1990s. From a Gini coefficient of about .25, the latest estimate (as of 2000) is now about .38. Among other things, there has been deterioration in indicators such as low birth weights during the 1990s, and a considerable drop in nutrition levels.<sup>7</sup> Nutritional sufficiency and deficiency, such as anemia, remains one of Cuba's major challenges.

### Future Sustainability

The foremost issue in the social sectors is the financial sustainability of these services given their high costs: they may need to be rationalized in order to continue to spend the same level—or reduce that level—given the increased demand for services in areas such as secondary, tertiary and technical education and health prevention, especially to curtail the spread of HIV/AIDS. Cuba spends a larger share of its economy on them than many other developing countries: it devotes about 10 percent of GDP to education and about 7 percent of GDP for health. This is twice as much as many other countries in Latin America and countries in transition. The level of spending not only reflects good quality services but public employment policies, geared to full employment, that expand employment in health and education. There are also issues related to control and

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<sup>5</sup> See "At a Glance: Cuba—the Big Picture", UNICEF, online

<sup>6</sup> See "Desarrollo Social", Government of Cuba, online, and "Zenith and Eclipse: A Comparative Look at Socio-Economic Conditions in Pre-Castro and Present Day Cuba", Bureau of Inter-American Affairs, Department of State, USAm January 1998.

<sup>7</sup> Nevertheless, the rate of low births in Cuba, at 8 per 1000 live births, is still comparable to the rate in Eastern Europe and the rest of Latin America.

command structures, such as the lack of choice by tertiary students, and ideology, such as mandatory summer schools in the rural areas.

Two statistics in Table 1 mark the high level of inefficiency in the social sectors: the very low pupil-teacher ratio in the case of education and the very high rate of doctors per 1000 persons in the case of health. Both of these reflect the use of these sectors to bolster employment. In health, there are other signs of inefficient use of resources: long hospital stays and low bed occupancy. In addition, there seems to be an overabundance of public facilities that could be rationalized, especially considering that most are dilapidated and the population is growing more slowly than in the past. The very low rate of investment in the country has had its effect on the social sectors: facilities tend not to be in good shape and suffer from shortages of modern equipment and inputs.

Current services may not be adequate for a globalized world where higher attainment in technical and tertiary education is demanded. Mandatory secondary education needs to be extended beyond 14 years and opportunities for tertiary education expanded. University education, the responsibility of the central government, is free but demand is managed. Students do not have choice on what they can study. A strong measure, taken in the early 1990s, instituted high entry standards. This vastly reduced tertiary enrolment from 242,000 in 1990 to 111,000 in 1995, only 12 percent of the potential student age population. The situation has been reversed and, by 2000, enrolment had recovered to about 180,000 students, a gross enrolment rate of about 25 percent, about average for Latin America. In the meantime, 120,000 youths, not studying and not working, have been enrolled in training programs. A recent measure to broaden access to tertiary education is the establishment of universities at the municipal. Little is known about the quality of Cuba's tertiary education and technical standards.

### Social Security and Protection

Other dimensions of Cuba's social policies—pensions and social assistance—have been less well studied and do not seem to have been subject to significant innovations over the years.<sup>8</sup> Cuba's pay-as-you-go pension system appears outdated, like many in Latin America and countries in transition, and its approach to social protection not likely to be adequate in the future. The fiscal deficit of the pension system, now accounting for more than 6 percent of GDP, is not likely to be sustainable, considering the significant declines in formal sector employment, low retirement ages, and increased life expectancy. There are also special regimes for the military, for example, that offer high entitlements. It should be noted that employees do not presently contribute directly. Some recent measures have been adopted to address the main weaknesses (e.g., increasing the retirement age over the next twenty years, increasing employer contributions) but are not likely to be sufficient.

Social assistance programs seem poorly targeted and small in comparison to the needs of vulnerable groups, especially considering the worsening of economic conditions

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<sup>8</sup> See "Cuba: Achievement and Deterioration of Universal Access to Social Services", Case study, Scaling up Poverty Reduction Conference, World Bank, Shanghai, May 2004.

during the special period. This was a common problem in countries in transition and countries in Latin America aiming to reduce poverty. Two specific issues in Cuba, emerging in the early 1990s, are nutrition standards and affordability of food stuffs. During the early 1990s, there was a sharp drop in nutritional standards, with total caloric intake falling by about 10 percent. That has since recovered but there are continuing signs of poor nutrition, for example, anemia among pregnant women, an increase in low weight babies and an increase in diseases such as diarrhea. Micro-nutrients may also be a problem, noting, for example, that salt was not iodized in Cuba until 1995.<sup>9</sup> Food rationing and price controls are still the vehicles for ensuring that basic needs are met. These measures are universal and their effectiveness has shrunk during the 1990s as rations have been cut and there is more food in the private markets. Proteins have particularly been cut back. A corollary is the drop in production of meat, eggs, and milk. Rations now meet about only one week of total food needs per month. In addition, it appears that programs such as school lunches and childhood facilities have been cut back.

### Subsidies, Housing and Basic Infrastructure Services

Cubans, including those in rural areas, have high access to basic services as compared to other countries in Latin America—for example, 98 percent of urban and 80 percent of rural populations have potable water and 80-85 percent owns its own house.<sup>10</sup> Micro-brigades, especially in the 1970s, were an important source of self-help construction, complementing public programs to provide the basic infrastructure. At the same time, there are concerns about the quality of these services, given the dilapidated state of public infrastructure: brown-outs are common, some services are provided only part of the day, water is trucked into rural areas, about half of housing is not considered in good condition, illegal slums have emerged in Havana, and there is considerable congestion and delay in public transport. More progress is needed to extend sanitation, with most Cubans dependent on septic systems and latrines. Only 20 percent of urban sewerage is treated. Solid waste handling is hampered by a lack of transport and processing facilities. Access to communication services is limited. Fiscal constraints, particularly in the 1990s, have curtailed construction efforts while the country has had several housing emergencies due to hurricane damage.

Cubans, with the average monthly wage rate, equivalent to about US\$ 10 per month, can pay for services thanks to price controls and subsidies that are not likely to persist in their present form in the transition to a more market based economy. There are only a few available statistics on the level and nature of the subsidies for public transport, electricity, water and housing. In the case of water, some 77 percent of families are reported to benefit from social tariffs for water consumption. Thus, Cuba is likely to face a serious challenge in designing appropriate pricing and utility tariff policies to ensure access by the poor and vulnerable, while liberalizing prices in the economy.

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<sup>9</sup> See “The State of the World’s Children”, UNICEF, 2001.

<sup>10</sup> For a review of housing in Cuba, see “Housing Policy in Castro’s Cuba”, by Teddy Kapur and Alastair Smith, HUT, May 2002.

## Productivity, Wages and Job Creation

One of the greatest weaknesses of the Cuban economy is the low level of investment and job creation.<sup>11</sup> Investment has averaged about 7 percent of GDP, insufficient for adequate maintenance. Official labor statistics are inconsistent and likely under-estimate labor participation. While the official unemployment rate is only about 3 percent, a significant portion of the working age population is considered as not active: there may be as many as 1.2-1.4 million Cubans who are of working age but are not active in the labor market.<sup>12</sup> The level of female participation, moreover, is lower than that found in countries in transition and OECD countries, albeit comparable to the levels common in Latin America, indicating that if women had more choice and opportunity to diversify their employment possibilities, female participation rates might be higher. Job creation appears to be managed, with available workers and school graduates engaged in the social sectors, keeping official unemployment rates low. As a result, overall productivity is poorer than in other countries. Besides the social sectors, this is obvious in the agriculture sector. Comparing Cuba to Dominican Republic, the share of agriculture in the economy is almost twice in the DR, at 11.4 percent, compared to 6.2 percent for Cuba, while the rural labor force stands at less than 20 percent in the DR, as compared to 23 percent in Cuba. It should be noted that restrictions on migration to Havana likely bolster rural populations.

Since 1990, Cuba's economy has changed dramatically although data are hard to reconcile. The shift is most evident in the surge in tourism and the disappointing performance of industry and agriculture. As of 2001, the share of industry was 17 percent and agriculture, about 6.2 percent, down from 8.6 percent in 1990. Because of the lack of raw materials, Cuba's import-substitution industries have been devastated: official statistics show that physical production is about 50 percent of pre-1990 levels, with the exception of petroleum, nickel, citrus, rice and cigars. Some industries—fertilizer, fishing, textiles, cement, and sugar—are operating at one third or less of their historical levels. In agriculture, sugar has been the target of a major restructuring effort with a number of sugar refineries closed down. Production has also fallen sharply in meat, egg, poultry, and milk (all produced in cooperative farms and some joint ventures) while output of vegetables, beans, and various tubers (more likely to be grown on private farms) has tended to increase. The government has been attempting to address these issues, restructuring industries, providing staff retraining and support for reinsertion in the economy. Salaries often continue to be paid. In the sugar industry, target of major restructuring in the last few years, some 100,000 employees have been laid off and being

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<sup>11</sup> This section is based on: "Cuba" Evolucion Economica Durante 2002 y Persepectivas Para 2003", CEPAL, July 2003, "The Slowdown in the Cuban Economy in 2001-2003: External Causes or Domestic Malaise" by Carmelo Mesa-Lago, undated, "Crecientes Disparidades Economicas y Sociales en Cuba" Impacto y Recomendaciones para el Cambio" by Carmelo Mesa-Lago, 2003, "Cuba: Country Profile 2003" the Economist Intelligence Unit, 2003; "Estrategias de Promocion de Exporttaciones: Efectos sobre la Pobreza, la Desigualdad, y el Crecimiento en America Latina y el Caribe: el Caso de Cuba en los Noventa" by anglea Ferriol el al, Instituto Nacional de Investigaciones Economicas, March 2003, and "The Cuban Economy, Structural Reforms and Economic Performance in the 1990s", CEPAL, December 2001. .

<sup>12</sup> Author's estimates based on a comparison of different data sources on population, age, employment, labor force participation, and unemployment.

retrained and/or have obtained employment in urban gardens which have also turned out to be significant sources of food for urban populations.

### Quality of Public Institutions

There is not much systematic information available on the quality Cuba's public institutions. Cuba is covered in the World Bank's database on governance research indicators.<sup>13</sup> These were analyzed as part of a specific review of governance and social justice in the Caribbean States, done by the World Bank for the Caribbean Group for Cooperation in Economic Development.<sup>14</sup> Using the six dimensions of governance covered by the indicators, the study showed that Cuba ranked very low on voice and participation. According to the ratings, this situation has deteriorated since 1996. Cuba rated average on political stability, given the tenure of the present government, and below average on government effectiveness, as compared to other Caribbean countries, such as Jamaica, Dominica, Trinidad, and Barbados which tend to have quite high capacities as compared to other countries in the region. Although the trend has been positive, this latter rating is likely due to chronic shortages of transport as well as deficiencies in basic public services. Cuba's ratings on the quality of regulations and the rule of law are low. The country rated relatively well on avoidance of graft and corruption. This was confirmed in the most recent survey by Transparency International (TI) on perception of corruption: in the 2004 study, Cuba ranked 62<sup>nd</sup> among 146 countries, with a score of 3.7 on a scale of 1 (worst) to 10 (best).<sup>15</sup> TI puts Cuba with the same corruption levels of Panama, Mexico, Colombia, Ghana and Thailand, but still far from Chile which has the lowest level of corruption in Latin America.

### Social Cohesion

This is difficult to measure in Cuba. There is a relatively high level of income equality, although equality deteriorated during the 1990s: the Gini coefficient now stands at about .38 (2000), as compared to .22-.25 in 1989. There seems to be a strong sense of nationalism and strong participation in mass political and quasi-political/collective organizations, community groups, public works campaigns, arts, sports and cultural events. On the other hand, there are limits on individual participation in social organizations, travel, social interaction and religious activities. The level of Cuba's social capital using internationally standard surveys has not been measured.

It is important to note the ways in which the Cuban population has been able to cope with the economic decline. A major part of this is remittances, even though not all segments of the population receive these funds. Another has been the diversion of private farm production to subsistence foodstuffs—more tubers and pork (which is not included in the list of “protected” foods included in the ration booklet). In addition, there has clearly been growth in the underground economy, including the less desirable

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<sup>13</sup> Access these indicators at [www.info.worldbank.org/governance](http://www.info.worldbank.org/governance).

<sup>14</sup> See “Governance and Social Justice in Caribbean States”, Development Research Group, World Bank, Discussion Draft for the Caribbean Group for Cooperation in Economic Development, no date.

<sup>15</sup> See “TI Corruption Perception Index”, Transparency International, 2004.

dimensions: corruption, prostitution, drug trafficking, and petty crimes. There are few statistics on Cuba's overall crime rate.

### Gender and Equality

Cuba has made major strides in eliminating legal biases and mandating social equality. On gender, advances have been in social services, access to reproductive health and education, to name a few.<sup>16</sup> On the other hand, one of the noticeable weaknesses is the absence of women in senior positions: Cuba ranks poorly on the number of females in high-level government ranks. Moreover, women do not participate in the labor force as much as in OECD higher income members and Eastern Europe (albeit about the same as most countries in Latin America) and, when they do, they are concentrated in the social sectors. There are increased reports of prostitution related to the tourism industry, with many sex-workers reported to be of African descent. Scarcity of consumer goods and low wages in other activities are said to be the driving forces for this phenomenon.

Similar concerns have been voiced on race.<sup>17</sup> Cuba no longer has an indigenous population. By about 1840, African descendents accounted for about 45 percent of Cuba's population. Emancipation was achieved in 1888 and, although discrimination worsened during the 1950s, exacerbated by the import of US segregationist policies, the Revolution swiftly moved to outlaw discrimination. In the last census (1981; a new census occurred in 2001 but the results are not yet available), Afro-Cubans were reported to account for about 34 percent of the total population. Based on available social indicators, it is clear that Afro-Cubans have benefited from the same social services as other Cubans. Yet, there are few Afro-Cubans in high-level, visible positions. The tradition of Afro-Cubans to work in the sugar industry, being scaled down, and the prejudices that appear to exist in the tourism industry mean that Afro-Cubans may not have the same economic opportunities as other Cubans. Also, Afro-Cubans are not as likely as others to benefit from remittances.

## **Part III: Lessons from Other Countries**

### Land Restitution, De-collectivization, Housing and Property Rights

One of the most important and difficult transformations that Cuba will face is the distribution of assets, now owned in the name of the state, to members of the Cuban public and other actors. There are three main groups of assets that would need to be distributed: (i) collective farms and state agricultural farms/lands; (ii) urban properties and state owned housing; and (iii) state owned productive enterprises. This paper focuses on the first two groups while the privatization of state owned enterprises warrants

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<sup>16</sup> See "Implementation of the Program of Actions of the ICPO", Background Document, UN Population Fund and CEPAL, November 2003.

<sup>17</sup> See "Social Exclusion in Latin America: Introduction and Overview" by Jere Behrman et al, Inter-American Development Bank, March 2002; "Discriminacion ethico-racial y xenophobia en America Latina y el Caribe" by Martin Hopenhayn and Alvaro Bello, CEPAL, May 2001, and "Cuba Begins to Answer its Race Question", by Eugene Robinson, Washington Post, 2000.

treatment on its own. Nevertheless, concerns related to privatization are addressed in subsequent discussions of the quality of public institutions, corruption, and crime.

Cuba will face the question of what to do with properties and lands previously owned by private individuals and corporations that were nationalized during the Revolution. The problem of what to do with these properties is not unique to Cuba, as many countries of the former Soviet block and Eastern Europe have had to do the same thing. There are also many past cases of nationalization and expropriation in Latin America—Mexico, Argentina, Chile, Peru, Bolivia, Nicaragua, and so on—that constitute a body of precedents. These experiences confirm that generally the state acknowledges, at least in a minimalist form, its obligation to compensate former owners.

There are three main affected groups: the first are Cubans who owned large tracts of land or more than one urban property, mainly apartment blocks, taken over by the state and redistributed and/or operated by the state. The second group is the Cubans who left Cuba and are considered to have abandoned their properties. These properties—houses, factories, businesses, offices, etc-- are now run by the state or occupied by individuals. And, finally, the third group is foreign owned corporations and individuals whose properties were nationalized. This occurred in the agricultural sector, along with communications, hotels, petroleum refining, and manufacturing.

Among the three groups, the third group—foreign nationals and corporations—is perhaps the easiest and/or most expeditious to resolve. Generally, there are international agreements or laws that guide the process with the involved nation-states acting on behalf of the claimants. Negotiated monetary compensation is the norm. The largest number of claims concerns the USA: the USA has recognized about 5900 claims totaling US\$ 1.85 billion.<sup>18</sup> Cuba has already settled claims with the next largest foreign investor—Spain—as well as France and Switzerland. Experiences with other countries in Latin America and Cuba’s own experience to date indicate that a negotiated settlement can be reached at only a fraction of the original claim. Some of these claims are settled collectively on the basis of a lump sum, with individual claims then paid out on a pro-rata basis. The alternative is for each claimant to pursue the claim on his/her own.

- Land Reallocation

Restitution of properties to local citizens and former Cuban nationals (or their heirs) as well as any foreigners who do not follow the collective process outlined above may be more problematic. Most countries in the Baltic and Eastern Europe have followed a policy of restitution to the original owners. On the other hand, the CIS countries and Albania pursued what is called a “tiller of the land” policy, giving preference in the distribution of state properties to workers who were actively engaged in agricultural production. Some countries (Hungary and Romania) have mixed the two. In most cases of land distribution, landless were given small plots free and workers required to purchase land devolved from state farms.

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<sup>18</sup> See “Cuba, the Morning After”, by Mark Falcoff, AEI Press, Washington, DC, 2003.

For those countries that pursued restitution, the starting point was the status of ownership at the end of the Second World War. Thus, countries set a specific trigger date to establish prior ownership (these dates were 1949 in Hungary, 1948 in the Czech Republic, and 1946 in Bulgaria). It should be emphasized that, by picking such post WW II dates, land reform carried out in the early years of the new communist regimes was not reversed as it was judged politically not feasible to take away land from those who had received plots under these land reform exercises. The prior owners then had a fixed period, usually six months, to present their claims. In addition, it was common practice not to evict persons from the property that they currently occupied regardless of a claim by the prior owner. If the original owner did want to reclaim an occupied property, then that person had to find the current occupier an equivalent property elsewhere.

Two main forms of restitution have been used by countries in transition with mixed results. The first form, mainly followed by CIS countries, was to provide the prior owner with a voucher, or a land share, representing the value (based on size and/or characteristics) of the original property. In the case of Hungary, this voucher was called a transferable value-denominated certificate which was not tradable and had to be used in an auction of public assets. This had the advantage that the owner could take time to seek out an available property offered for sale by the state, or another asset being sold by the state of an equivalent value. The voucher system also meant that the management of the land holding did not usually change and the same workers continued to be employed, both an advantage and a disadvantage. The second form, followed by most Eastern European countries, was to restore the exact property or its proxy to the original owner. In some cases, a computer program was used to divide land among claimants, resulting in non-contiguous land holdings and unusual shapes. This may have been expeditious but not necessarily helpful for using the land for productive purposes as restitution in general terms is thought to be regressive and tended to transfer land to an older generation, less interested or able to continue production. Thus, both forms have their pros and cons. Facilitating choice, however, as Hungary did, seems to be quite successful and might be the best to balance interests of fairness, productivity and distribution. This system permitted those who occupied the property—particularly relevant in the case of housing and collective farms—to continue possession without disruption.

Similar processes were used to distribute land by the collectives and state farms. Since most of these farms were nationalized as part of prior land reform programs, the original owners either did claim (settling for monetary compensation instead) and/or did not have a recognized right to claim (since ownership prior to the trigger date). A distinction was usually made between state farms (owned by the state) and collective or cooperative farms (deemed to be the property of those who worked there). In Eastern Europe, state farms were typically privatized, sold or auctioned as going concerns. In Poland, which did not have a program of restitution but already had a high level of private land ownership to begin with, state farms were auctioned to the highest bidder, a process complicated by the farms' high debt burden but largely successful.

On the other hand, most collective farms were “corporatized”, that is, converted into legal entities with joint ownership by members. They continued to be run by the

former managers and to employ the same workers. Active employees and retirees of collective/state farms were given either a voucher equivalent to their respective shares of the farm or the chance to withdraw from the collective with a determined share of land and assets. But the land share, representing a fractional value of the whole farm, was not necessarily divisible or tradable: the new owner had to negotiate with the collective a specific plot to be subdivided. Only in a few countries were collective farms actually dissolved. In the case of Albania, which did also not offer restitution to the prior owners, all state farms were divided among rural residents with absentee former owners receiving state bonds in lieu of property. Armenia and Georgia also took the step of fully dismantling collective farms while Slovenia never did adopt collective farms.

As a result, with a few exceptions, collective ownership persists and land ownership remains in a state of flux while the vouchers are being held, inhibiting investment and reactivation. Few individuals have actually taken up their direct shares, continuing to participate in the collective farming structure, largely because of the fear of leaving its supportive umbrella. Some of this reluctance may be exacerbated by the weak supply and distribution of agricultural inputs to small farmers. In addition, even after more than ten years of transition, significant portions of arable land remain in the hands of the state. As of 1997-98, the extent of state owned property remains high: in Lithuania 63 percent, Estonia, 43 percent, Romania, 29 percent and Poland 15 percent. In the case of Slovakia (as of 1996-97) only 5 percent of farms were individually owned.

- Farm Size

Concerns about farm size surfaced especially in CIS countries.<sup>19</sup> At the outset, collective/state farms in the Soviet countries were very large: an average of 2000-3000 hectares with 300-500 workers each. This contrasted with the experience of Canada and the USA in which farms average about 200 hectares each, or of Argentina, with an average of over 400 hectares each. Generally, Soviet style state farms and cooperatives are considered too big to manage efficiently. At the other extreme, there were millions of household plots averaging 0.5 hectares, considered too small to be productive. As a result, at the end of the process of land reallocation, there was the continuation of many too large structures while restitution recreated farming structures that were fragmented. In the case of Bulgaria, for example, land restitution generated some 8.3 million individual plots with farmers continuing to operate with an average size of 4.7 hectares, providing an essential source of income and food, but not likely efficient production.<sup>20</sup>

Fortunately, the problems of farm size seem to be dissipating with time. Small individual farmers have been either joining together in associations or consolidating plots via purchases or leasing, to increase their land holdings. By the late 1990s, individual farm size increased many times over in almost all countries in Eastern Europe—Bulgaria, Czech Republic, Slovakia, Hungary, Romania, Estonia, Latvia, and Lithuania. Only

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<sup>19</sup> See “Land Policies and Evolving Farm Structures in Transition Countries”, by Zvi Lerman et al, Hebrew University/World Bank, January 2002

<sup>20</sup> See “Agricultural Situation in the Candidate Countries: Country Report on Bulgaria”, European Commission, July 2002.

Poland and Slovenia saw small changes in average individual farm size. At the same time, the average size of collective farms and state farmers has reduced considerable as well, indicating that market forces are working in the right direction to avoid the problems of too large--or too small—land holdings.

It is not clear how serious a problem of land fragmentation Cuba could face. Available data on land use are hard to reconcile and the following figures may not be accurate.<sup>21</sup> At present, some 17 percent of cultivated agricultural land, about 2.5 million hectares, is owned by about 140,000 private farmers yielding an average private farm size of about 3.0 hectares. About 25 percent of total cultivated land is in the hands of about 150 state farms, yielding an average size of about 4,100 hectares each. The balance of agriculture land is in the hands of about 3000 cooperatives and basic agricultural units, averaging about 460 hectares each (FAO considers that these still may be too large for cooperative management).<sup>22</sup> In light of what has happened in Eastern Europe, it looks like Cuba should focus on dividing state farmers into manageable units while setting up processes to encourage small farms to consolidate and/or form associations.

- Housing

Housing in countries in transition, which was generally considered to be in poor shape, was also distributed or restituted following the same processes as used for land.<sup>23</sup> There were two complications. The first was that, in many former Soviet countries, especially Russia, it was common for housing and other social benefits to be linked to employment in state owned enterprises. In Russia, only some 25-35 percent of the housing stock was in private hands. The rest was tied to enterprises so that the distribution of these housing units (and other social benefits) was constrained by what happened to the enterprise. As discussed below, most of these assets continued to be held by the enterprise and were not distributed. In Romania, where housing linked to employment was less of an issue and there was more privately owned housing in the first place, about 30 percent of the housing stock was distributed, usually at low prices and with low cost financing, to the occupants. The second problem was what to do with large apartment blocks: usually they were either turned over to local governments to manage or converted to occupier-ownership in the form of condominiums. However, neither of these two alternatives proved successful, as both lacked the means to carry out needed repairs or pay for common utility services. This situation was exacerbated by the delay in liberalizing the rental markets and concomitantly establishing systems to subsidize renters who could not afford to pay market based rents, as discussed below.

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<sup>21</sup> Data from FAO and CEPAL differ on total agricultural land in Cuba, ranging from about 2.1 to 2.5 million hectares. About 2 million hectares are devoted to sugar production. Overall, about half of Cuba's total surface is considered arable, with a small share is actually cultivated permanently (likely by small-holders). Much is as pasture or cultivated only seasonally. The balance is forested.

<sup>22</sup> See "Cuba: Agricultural Sector—Summary Note", excerpts from the FAO Investment Center Report: "Cuba—El Sector agropecuario: Tendencias y Prioridades para Inversion", FAO, December 2003.

<sup>23</sup> Evaluations of housing stock and policies in Eastern Europe have been carried out by UNECE: in the case of Romania, the country housing profile was carried out in 2000. For an example, see "Country Profiles on the Housing Sector: Romania, Report No. ECE/HBP/124, UNECE, 2001.

As compared to some countries in transition, Cuba should face less of a challenge distributing housing. Cuba already has a high degree of homeownership—about 80-85 percent—since most housing was not nationalized and the balance of the housing stock is already in the hands of local municipalities and not linked to employment in state-owned enterprises (although some is managed by unions). Thus, Cuba can avoid many of the problems that countries in transition have encountered. Nevertheless, distribution would be facilitated if the rental market would be liberalized, something which had not yet been done in Romania, for example, as of 2000. The key would be to encourage movement of renters to unit that they can afford (in terms of utility payments, maintenance and rents) and/or offset market based rents for those with insufficient incomes.

- Property Rights and Markets

The institutions in charge of the process of land distribution and restitution are very important. The process in countries in transition has proven to be very time consuming and highly dependent on the quality of property records and the legal system to resolve disputes. The difficulties that can be faced are exemplified in the case of Nicaragua (see Box 2). In fact, land tenure institutions are notoriously weak through all of Latin America and it is likely that Cuba will face these same challenges.<sup>24</sup>

**Box 2: Nicaragua: Land Regularization**

Commodity booms led to a concentration of land ownership since the 19<sup>th</sup> century. The Sandinistas reversed this, confiscating and distributing about 35 percent of the total land to former workers or state owned enterprises. Some land was seized for military reasons. However, title over these lands was not clear, leading to a flood of claims under the Chamorro government. The status of many large cooperatives was also in question due to the inability to determine whether or not current members are rightful owners, complicated by the breakup of cooperatives into individual plots. The Chamorro government carried out its own land reform program, distributing frontier property to ex-combatants. Again, often the title was not clear. The situation was further complicated by land invasions by landless, repatriation of refugees, privatization of state-owned enterprises, and superposition of laws. To address these issues, the government created the National Confiscation Review Commission. This agency is in charge of hearing property claims relating to confiscation by the Sandinista government. By 2002, it had heard almost 20,000 claims, of which almost 95 percent have been resolved. About 15 percent of claims were denied, in about 6 percent the property was returned to the claimant, and in the balance of cases, claims were settled with monetary compensation. As of 2002, almost US\$ 1 billion has been authorized in indemnities mainly to Nicaraguan citizens. In addition, there is a separate process for regularizing titles for some 150,000 urban and rural properties distributed under the Chamorro Land Reform. The first step was to provide property holders with documents clarifying their ownership. Another office, then, is to issue formal titles, acting upon about 33,000 urban titles and 38,000 rural titles from 1992 to 2002. Finally, the State Attorney's office prosecutes cases in which individuals sought to enrich themselves under the Land Reform program. Among over 7000 such cases, only in 20 cases have sentences handed down. In light of the sensitivities over property rights, the Supreme Court has authorized the setting up of four specialized property appeals tribunals, with only 83 cases resolved in the first two years.

**Source:** Housing Rights in Nicaragua: Historical Complexities and Current Challenges, Joint Mission Report, Center on Housing Rights and Evictions, 2003

Most countries in transition did not possess a complete cadastral record of land holdings. Mapping was fragmentary and the process of restitution complicated by

<sup>24</sup> See “Mercados de tierras agrícolas en América Latina y el Caribe: una realidad incompleta”, CEPAL, July 2003.

cumbersome urban planning procedures, disputes, and delays in resolving claims in the courts. It is estimated that, in Bulgaria, as much as 40 percent of the court's work loads involve property claims.<sup>25</sup> Countries have been slow to set up cadastral agencies, properly fund mapping and records, and expedite claims. Restitution was only complete in Bulgaria in 1999, taking about 10 years. Such delays have inhibited investment, subsequent land sales and the consolidation of holdings into more economic units.

Even after 15 or so years, there is still much to do in countries in transition and Cuba would be well advised to begin this process early. In retrospect, countries in transition acted too slowly and should have undertaken land reform and setting up of property markets early in the transition process.<sup>26</sup> Delays have kept ownership in flux and inhibited investment: there is considerable evidence that land titling increases investments and production. As of the end of the 1990s, there has been limited development of land markets to enable owners to transfer rights, lease, sell, inherit, and mortgage their property. The land market only started to function in Romania in 1998, hampered by high fees for surveying and notaries. The transfer of property rights goes hand in hand with the development of procedures that allow regrouping of land and assets according to the preference of the new owners. A properly functioning land market depends on intermediary functions such as lawyers, real estate agents, title companies, banks to provide mortgages and so on. Moreover, in most cases, the new owners still do not yet have clear title of their property with only transitional title granted as part of the restitution/distribution process. The backlog on receiving final title is significant and hampers future sales and using property as collateral. A final concern for Cuba to watch out for is "distress" or improvident transfers and sales that may put vulnerable groups into a disadvantaged situation *vis a vis* new buyers.

Some countries, including Vietnam (see Box 3), have circumvented these problems by facilitating interim arrangement such as leasing. Since many states continue to own large tracts of land, leasing allows them to put state land to productive use and generate revenues. Leasing also allows farmers to overcome the problems of fragmentation and to amass viable plots of land without requiring full title. This has proved to be a good option for the elderly or urban absentee owners who do not wish to produce actively and for collective/cooperative farms to avoid the legal problems of dismemberment. An interesting legal option has been the formation of partnerships and associations among farmers: in the case of Romania, after rapid breakup of collective farms, 48 percent of land has since been consolidated into farmer associations.

Based on the experiences of countries in transition, Cuba appears to have the opportunity to combine restitution with distribution and achieve a high level of social equity while avoiding overly fragmented land holdings and abuse by local elites. The mixed strategies followed in Hungary and Romania, closely followed by Bulgaria,

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<sup>25</sup> See "Project Appraisal Document for a Proposed Loan for a Registration and Cadaster Project., Report No. 22204-BUL, World Bank, May 2001.

<sup>26</sup> See "Land Reform in the 21<sup>st</sup> Century: New Challenges, New Responses" by Roy Prosterman and Tim Hanstad, RDI Reports on Foreign Aid and Development, No. 117, Rural Development Institute, March 2003.

Estonia, Latvia, Lithuania, Czech Republic, and Slovakia, appear to have been the most successful in balancing equity and efficiency concerns. The best programs have encouraged near universal coverage of potential beneficiaries, including pensioners (or their heirs) of the distribution of assets of collective/cooperative and state farms. The best ones have also included shares of machinery, livestock and other non-land assets in the distribution. Gender equality has been an important principle: women should receive equal rights to distributed land. Involvement of local communities, as shown in the case of Vietnam, can be very helpful in maintaining equity and avoiding abuse.

**Box 3: Vietnam: Land Allocation in Transition**

Vietnam remains an agricultural economy with a large share of its population relying on family run, subsistence farms. While opening of the economy has generated strong growth and helped to raise the standard of living, Vietnam started from a low base with extensive poverty and underdeveloped institutional structures. Since 1986, when the government began Doi Moi, or renovation, the country has steadily been moving away from a centrally planned economy. The 1988 Land Law transformed collectivized agricultural production to a system based on house-hold initiative: while land ownership remains in the hands of the state, individuals are allowed to rights over property. Households are granted long term use of land and the freedom to cultivate it how they wish. De-collectivization was largely complete by 1990. At first, land reverted to the state if the household moved or stopped farming. A new law in 1993 since allowed householders to inherit, transfer, sell, lease or mortgage land use rights and to receive compensation in case of expropriation. The new law extended the duration of land use to 20 to 50 years depending on the crop. The results are considered positive. The country has turned from an importer of rice to the world's second largest exporter as of 1998. Equity has largely been preserved and Vietnam was able to avoid local capture. The program actively promoted peasant organizations and used the press to channel information and expose corruption. One of the reasons for the successful outcome is the strong coalition between reformers and farmers who had been long dissatisfied. The ability to transfer rights now allow those with too little land (common for the landless) to amass more land, and those with other opportunities (and too much land) to exit. Nevertheless, households with long ties to the community, with male heads and with more education tended to benefit most from land allocation.

**Source:** Land Allocation in Vietnam's Agrarian Transition, by Martin Ravallion and Dominique van de Walle, World Bank Policy Research Working Paper 2951, January 2003

- Environmental Aspects

A problem that Cuba could face, and which has not been given much attention in countries in transition, is the environmental consequences of land reallocation. It may not be in the best interests of Cuban society to restore all lands to individual owners with the intention of continuing or intensifying agricultural production. Because of the past expansion of sugar production in non viable lands, Cuba now has a serious problem of land degradation. It may be wise to withhold certain lands (e.g., those already earmarked by the government for reforestation and conservation), converting these properties to national parks, protected areas, or simply fallow fields. The estimated amount of land now used for sugar cultivation that should revert to non productive use is about 1 million hectares or approximately half that devoted to sugar in the past. Attempts to reactive cattle production, given the lack of domestic feed and Cuba's proclivity to droughts, could also be problematic for Cuba in the future. Thus, there should be serious thought given to sustainable land use as part of the process of land reallocation.

## Subsidies and Affordable Food, Housing and Basic Public Services

One of the first things that Cuba will have to do is liberalize prices and wages. Many prices and wages will likely rise, reflecting supply and demand, as they did in all countries in transition. Generally this ought to be seen as a good thing to order to establish the right signals for the economy, but there could be negative effects. Inflation, especially a sudden inflationary crisis, is harmful to the poor: they have less bargaining power to demand wage increases to offset higher prices, fewer assets to deploy to maintain consumption, and less access to private sector support and remittances. The poor will be particularly sensitive to price increases for housing, services such as water, electricity and transport, housing and food stuffs since these basics use up the majority—if not the totality—of their incomes. Those without much income earning potential to start with—the retired, disabled, unskilled, poorly educated and unemployed—and those with large families are typically the most vulnerable.

Countries in transition have confronted these problems. In some countries, such as Russia, the situation was complicated by the bundling of public services with employment in state-owned enterprises (as noted above in the case of housing).<sup>27</sup> When enterprises were privatized or they faced under budget constraints, they could no longer afford to provide employees with a range of services—housing, child day care, health, transport, cafeterias, holiday homes, and others—nor was the state prepared to take over these services. As a result, the majority of firms in Russia, for example, still provided, as of the mid 1990s, these benefits to their employees while only 25-35 percent of firms in other countries in transition did so. Even though firms may have continued to provide substantial non-wage benefits to their employees, many introduced greater cost recovery. An anomalous situation has occurred in which workers are nominally kept on the rolls as employed by an enterprise even though they do not work or receive any wages.

As noted above in the case of housing, Cuba has the advantage that most social services are not provided directly by state enterprises and farms. Thus, it should not face the same complications as, say, Russia. Nevertheless, it will no doubt confront the general issue of how to protect the vulnerable from rapid increases in prices, especially food stuffs, rents and basic utilities as prices are liberalized.

- Pricing of Food Stuffs and Basic Services

One of the first areas to see prices liberalized has been agriculture: almost all countries in transition liberalized agriculture prices early in the transition, providing considerable impetus to agricultural production and enhancing rural family incomes. Doing this could be complex in Cuba. Although prices in Cuba for some agricultural markets are already based on supply and demand, price liberalization could have considerable impact on products that are currently protected under Cuba's food rationing program that would have to be converted to cash equivalent as part of a more general income support program (or a voucher system). There is little documentation on how

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<sup>27</sup> For a discussion of the problems faced in restructuring state owned enterprises, see "Enterprise Restructuring and Social Benefits", by Simon Commander and Mark Schnkerman, EBRD, no date.

countries in transitions actually did this, and how they coped with the impact on the affordability of foodstuffs other than to enhance their social protection programs, as discussed below. It is not clear that the rise in food prices resulted in any sustained negative impact on nutritional levels and other health indicators, such as low birth weights, among populations in Eastern Europe (also see below).

There is more known about what countries in transition did in adjusting prices of basic services. Like Cuba, countries in transition in Eastern Europe started out with high levels of access to services, even better than for Latin America as a whole. So, the problems facing these sectors were not coverage but the quality of service and pricing. Overall, most countries in transition seem to have responded slowly and poorly to adjusting utility prices and improving the quality of service.<sup>28</sup> Their first reaction was to avoid the problem by retaining controls on key services. For example, even though price controls on food stuffs were largely eliminated in 1992/93, Russia continued to control utility prices keeping them well below long-run marginal costs. Some governments also tried to encourage suppliers to avoid disconnecting those clients in arrears.

But this approach soon proved to be unfeasible financially and, during the 1990s, government after government has decided to bring prices/tariffs closer to supply costs. In the case of Poland, this process has been gradual, and slower for some services than others: district gas (the main source of household heating) was the most protracted. In most countries in transition, consumers have seen utility prices increase many times over. Even then, many countries in transition—with Russia being one of the worst—are far from charging utility tariffs at long run marginal costs. As of 2000, the closest were Poland, Estonia, Latvia and Lithuania averaging about 60-80 percent of marginal costs. Housing rents are still controlled in Romania.

Thus, the continuation of price controls on basic services constitutes a large fiscal burden for many countries in transition, something that Cuba should work to avoid. Moreover, the lack of appropriate utility pricing policies and overall regulatory clarity is thought to be one of the reasons for the slow rate of investment in basic infrastructure, and housing, perpetuating poor services and low levels of production still seen in countries in transition. Given the low quality of service in Cuba, one of the first priorities ought to be encouraging investment.

- Subsidy Options

Cuba can look at the variety of options to adopt economically justified utility prices while making sure that vulnerable groups are protected.<sup>29</sup> Typically, the approach in countries in transition and in Latin America has been to liberalize prices and/or put them on an economically justified basis (i.e., long run marginal costs), while eliminating

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<sup>28</sup> See “Maintaining Utility Services for the Poor: Policies and Practices in Central and Eastern Europe and the Former Soviet Union:”, World Bank, September 2000.

<sup>29</sup> See “Making Infrastructure Reform World for the Poor: Policy Options based on Latin America Experience: by Antonia Estache, Vivian Foster and Quentin Wooden, LAC Regional Studies Program, WBI Studies in Development, no date.

special deals for particular groups (e.g., the police, military, judges, and the handicapped). The next step has been to transfer the cost of subsidies where justified to the state, accompanied by new policies to institute progressive social tariffs at the utility level with some cross-subsidy among consumers if possible.

**Box 4: Chile's System of Water Subsidies**

In the late 1980s, Chile began an overall of its water and sanitation sector, part of which entailed steady increases in tariff levels through the 1990s. As a result, a new mechanism was needed to protect vulnerable households. Since connection was nearly universal, the issue was consumption, not high connection fees. Chile chose a means-tested subsidy, targeted to individual consumers, rather than geographic zones or universal subsidies. Under this program, the government reimburses water companies on the basis of the actual consumption by each beneficiary. The subsidy covers 20-85 percent (depending on the region) of the household's water and sewerage use, for up to 15 m<sup>3</sup> per month, with the consumer paying the balance (as of 2003). The goal is to keep water and sewerage costs to no more than 5 percent of total household income. In effect, the subsidy provides a discount on the regular water tariff rate for the first block of consumption, and acts as a means-tested access to a rising block tariff. The water company bills the beneficiary for its share and then bills the municipality for the balance. The municipality in turn gets its funding from an earmarked grant from the central administration for an agreed number of beneficiaries. Metering of individual consumption is thus a prerequisite for the system to work. Eligibility of the household is determined by the local social agency using a standardized system of assessing household need based on a questionnaire. This evaluation system is used in the entire country and provides access to the household for this and many other social programs. Nevertheless as of 1998, targeting errors remained quite high: as many as 60 percent of beneficiaries are in the upper 30 percent of the population indicating that the targeting system could be tightened. The reason for this is that water tariffs vary considerably in Chile (mainly reflecting scarcity). Hence, in keeping to no more than 5 percent of household income, it is possible to include relatively well off families. Still, Chile's water subsidy program is considered more effective than that adopted in Colombia, another of the few countries in Latin America to have instituted formal system of water subsidies. In Colombia's case, the system is based on geographic location and provides almost universal access, regardless of income level.

**Source:** Incentive Based Subsidies: Designing Out-put Based Subsidies for Water Consumption, Andres Gomez-Lobo, Public Policy for the Private Sector, Note No. 232, World Bank, June 2001; Water Subsidy Policies: A Comparison of the Chilean and Colombian Schemes, by Andres Gomez-Lobo and Dante Contreras, the World Bank Economic Review, Vol. 17, No. 3, World Bank 2003

Options for doing this, varying by sector, come from experiences in Latin America and world wide. Some of the choices have to do with ensuring access, by requiring universal service obligations and subsidizing connection costs for the poor; other options have to do with reducing cost by adopting new technologies and alternative designs. In the case of electricity, there is convergence on the use of a life-line tariff structure to charge a lower rate for the first block of consumption, benefiting small consumers, typically poorer. In the case of water, a common approach has been to charge raising block tariffs with a low price for the first block but there are many advocates for uniform pricing combined with special discounts for particular kinds of consumers, e.g., those that use stand pipes, or those living in a particular area as a proxy means-test.<sup>30</sup>

The use of proxies to determine who is poor and design pro-poor programs are discussed more extensively in the next section. Needless to say, there are many options:

<sup>30</sup> See "Water Tariff Design in Developing Countries: Disadvantages of Increasing Block Tariffs and Advantages of Uniform Price with Rebate Designs" by John Boland and Dale Whittington, John Hopkins University, no date, and "Pricing, Subsidies and the Poor: Demand for Improved Water Services in Central America:, by Ian Walaker, et al, no date.

whether they should be handled by the service provider or by the state as part of its overall social protection program. The subsidies can also be paid out as a rebate or compensation directly to the utility, as in Chile for water subsidies (see Box 4) and in Romania for winter heating allowances, or paid directly to the consumer. The subsidy can be paid as a voucher earmarked for the service or a general cash transfer to supplement overall household income. In almost all cases, there are problems of errors of exclusion and inclusion; that is, either too many rich benefit or too few poor are included.

The provision of affordable housing is also amenable to similar pro-poor strategies. Cuba, like many other countries, has a serious backlog in affordable housing that public financing and housing construction have not been able to reduce. Looking ahead, it is not likely, with the competing demands for public finances, that Cuba will be able to devote more public resources to housing. Thus, one of the policy options for Cuba to consider is to rely on private construction and financing, with the state's role to provide subsidies to those who otherwise would not be able to afford basic housing.

Many countries in transition and Latin America have been adopting such a system whereby the role of the state is to provide demand side subsidies, in the form of capital grants and/or housing allowances, instead of supply-side assistance.<sup>31</sup> Such demand-side subsidies are now being used to protect vulnerable households from high rents and/or to respond to housing crises, such as an earthquake in Armenia and military redeployment in Russia. Housing allowances and/or capital grants are now common in many Eastern European countries, as well as several countries in Latin America, such as Chile, Costa Rica, Colombia, Uruguay, Mexico, El Salvador, Panama and Paraguay.

**Box 5: Chile's Demand Driven Housing Program**

Chile is one of the few countries in Latin America that successfully reduced the back log of affordable housing. Since 1990, when the current coalition of socialists and social democrats came into power, Chile has supported the construction of an average of 100,000 housing units per year, accounting for roughly half of total housing construction in the country. Chile has had a long standing social housing policy that has evolved over time, ranging from eradication of slums in the early period to new solutions such as capital grants: this replaced a system of low cost credit that suffered from high rates of arrears. The present system is to provide direct capital grants equivalent to no more than 25 percent of the total cost of a new dwelling meeting certain standards. Most government assistance is reaching the poor. Yet, there are concerns. The first is about the quality of life associated with these housing developments: because of the incentive to lower costs, developers sought out the cheapest land, usually far from the city center and away from services and commercial activities. This led to a high concentration of households with vulnerabilities, urban and social segregation, disparity in access to services, and problems of security. Another concern has been construction standards especially in terms of design, green space, drainage, etc. Finally, there are concerns about the coordination of housing with other policies, notably integrating social services into new housing complexes. Such concerns are addressed in the next phase of the government's housing program.

**Source:** A Quality of Life Assessment to Improve Urban and Housing Policies in Chile, by Paula Jiron and Giulietta Fadda, University of Chile, University of Valparaiso, 2003; El Programa de Vivienda Progressiva en Chile, 1990-2002, by Margarita Greene, IDB, July 2004; The Long Road to Housing Reform: Lessons from the Chilean Experience, by Edmardo Rojas, IDB.

<sup>31</sup> See "Ensuring Access to Essential Services: Demand Side Housing Subsidies:", by Harold Katsura and Clare Romanik, Social Protection Discussion Paper Series, No. 0232, World Bank, December 2002.

One of the ways used in countries in transition to determine the appropriate level of housing subsidy, either an allowance or a capital grant, is called the gap formula. This approach first calculates the limit of acceptable housing expenses, based on market costs, social norms and family size (the payment standard). The subsidy is set to compensate the family for the difference between that level and a reasonable level of household contribution (the burden level, typically 10 to 25 percent of household income). Another way, norm based, is to provide a fixed subsidy based on what the market would normally charge for appropriate housing. The family then pays the difference with the actual rent and the subsidy, providing a strong incentive to find the least cost housing if it is allowed to retain the difference. The housing allowance could include other costs related to housing, such as water and electricity charges.

- Targeting the Poor

Directing subsidies for food, housing and basic services is dependent on knowing and designing cost effective mechanisms for identifying eligible persons and families. (The same arguments hold for income support/social protection programs discussed in the next section.) A problem in countries in transition has been the lack of data—or access to data—on household income and consumption on which to base the design of subsidy and pro-poor programs. A particular concern is the lack of panels that enable researchers to track individuals over time. Countries such as Armenia and Albania have very poor statistics while in other countries the data may have existed but were not used widely for political reasons. Few countries have official poverty lines. As of the late 1990s, Latvia did not have an official poverty line although it was moving towards an institutional threshold for defining benefits. Romania defined poverty solely on the basis on nutritional intake.

The lack of data or access to data makes it difficult to assess the aggregate impact of the cost of services on household expenditures and to determine what individual services should cost as a share of total income. Many countries have coped with this by establishing limits and defining eligibility for subsidies on the basis of the share of household income. Some poverty experts advocate spending not more than 15-20 percent on public utilities and not more than 25 percent on rent/housing costs.<sup>32</sup> Generally in countries in transition the burden limit for utilities averaged about 15-30 percent: in the case of the Ukraine, it was 20 percent (1998). These norms may be helpful but, they need to be put into the context of a given country. The following is an example of the kind of analysis that can be done, in the case of Argentina (see Box 6) to assess the aggregate impact of utility prices and design an integrated subsidy program accordingly.

Key for Cuba—and most other countries—is to have the institutional capacity to collect and analyze data on incomes, consumption and living standards, and to formulate

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<sup>32</sup> The rationale for these levels reflects the underlying definition of poverty being used: the poverty line is usually defined as twice (or a bit more than) the amount needed for only food: thus, if 15-20 percent is used on public utilities and 25 percent on housing, plus 50 percent on food, almost all of the income threshold defining the poor is accounted for, with little left for clothing, out-of-pocket medical costs, school related expenditures, etc.

policy on the basis of those data. This is especially important during transition as it is likely to be a period of rapid change, including bursts of inflation. Traditional methods of data collection (e.g., large scale surveys, census), thus, may not be enough and countries may need to add quick response mechanisms, as done in Argentina in the early 2002.

**Box 6: Argentina: An Example of Targeted Public Utility Subsidies**

A recent study done by the World Bank on Argentina shows that it is feasible to construct social tariffs and accompanying targeted subsidies that would be more effective than those currently used for water, electricity, and natural gas. Current subsidy programs are all relatively progressive and have moderately high levels of errors of inclusion (around 40 percent). Their main problem is that they have very high errors of exclusion (70 percent). Thus, far too few of the poor benefit while a relatively large share of the non-poor do. The starting point for the proposed new system was to define minimally acceptable consumption for each service and to set a maximum share of family income to pay for them—15 percent. A specific provision was made for connection costs which are high in the case of water and sewerage. Using a series of proxies to define poverty, based on readily accessible and reliable data on social conditions in the country, the results of the study demonstrated that a multi-variable proxy for poverty with subsidies targeted to this population could bring errors of exclusion down to 40 percent for water and sewerage, and about 30 percent for electricity while keeping errors of inclusion to about 40 percent or less. Targeted subsidies for connection fees were particularly effective to ensure coverage of the poor. In addition, the study showed that these changes could be made within the same financial envelope as the current subsidies.

**Source:** Towards a Social Policy for Argentina's Infrastructure Sectors: Evaluating the Past and Exploring the Future, by Vivien Foster, World Bank Policy Research Paper 3422, October 2004

Cuba is already working on overcoming data limitations. At present, the Cuban government and research institutions are collaborating with the World Bank, IDB and UNDP to carry out household living standard surveys. This data collection effort collect will allow determination of purchasing power parity (a way of comparing income across countries), assessing household income and consumption and analyzing poverty.<sup>33</sup>

Wages, Labor Dislocation, Pensions and Social Protection

The third main challenge for Cuba will be the transition from an economy in which wages are set and job creation managed by the state to one in which labor will be compensated and jobs created in response to supply and demand. In this case, Cuba starts from a low basis in terms of the quality of infrastructure, productive capacity (except for some industries) and productivity. Inflation would be a particular concern, when some will be left behind, undermining equity and adding demands for social protection. The situation will be dynamic: some jobs will be destroyed and new ones will be created; some employees may see their real wages fall, while others will see their incomes rise, creating greater wage disparity; some unemployed will continue to seek work while others may drop out of the labor force. Some people, currently not active, may decide to seek employment. Some working in the informal sector may become formal employees while others may enter the informal market, especially to avoid high non-wage labor costs, taxation, regulations to set up new businesses, and other costs associated with formal employment.

<sup>33</sup> Some early results of this effort were presented at the conference on Governance and Social Justice by Lia Ane, Investigator, Center for Population and Development Studies, and Adjunct Professor, University of Havana, Cuba.

- The Informal Economy

A key concern in countries in transition, applicable to Cuba, has been the size of the informal economy, typically made up of small and medium-scale enterprise (SME). Cuba already is likely to have a substantial informal economy although there is no estimate, along a substantial share of the working age population, inactive. In the case of countries in transitions, estimates of the size of the underground economy average about 32 percent of reported GDP but vary from 10-15 percent in Eastern Europe (e.g., Hungary and the Czech Republic) to 34 percent in Russia and 50 percent in countries that made up the former Yugoslavia and Armenia. As a policy goal, it is desirable for these informal activities to join the formal economy.

Given that private activities were usually restricted prior to transition, and that there were likely substantial under-ground economies, incorporating the informal economy into formal processes is extremely important from the point of view of tax collections/public finances, access to bank credit, ability to regulate the economy (e.g. enforcing labor standards for employees, work safety, minimum wages, etc) and participation in any social programs linked to employment (e.g. pensions, health care). If restrictions on private enterprise lifted, it may well be the case that many from the underground economy enter the formal market, leading to a rapid jump in reported economic activity and employment.<sup>34</sup> In Poland, new private activity in manufacturing grew by 40 percent in 1991, and then expanded 25 percent per year for the next five years. Poland, Hungary and the Czech Republic did well in this regard, aggressively reducing barriers to new enterprise formation. Thus, in these best performers, small enterprises now account for 40-50 percent of jobs and value added.

- Unemployment and Low Wages

But, overall, experience in countries in transition has been disappointing and job creation remains a challenge even after fifteen years. Cuba will likely face similar problems, especially given overstaffing and the poor condition of most state owned enterprises. Part of the problem is job destruction as enterprises are put on a more economic footing, with long lags in creating opportunities in new firms, leading to high levels of unemployment. Another dimension is depressed real wages. Eastern European countries experienced a drop of about 25 percent in real wages, and an increase in unemployment of 12 to 15 percent at the start of the transition in the early 1990s.

The state owned sector in countries in transition was hit the worst. In Slovenia, there was a 15 percent drop of employment in state-owned enterprises in the early 1990s. In the case of Bulgaria, the drop was 27 percent between 1989 and 1993, almost all of that from state-owned industrial enterprises. Total state employment in Bulgaria's industrial sector was cut in half. Russia saw less of a drop in employment during the mid-1990s as compared to other countries in transition but experienced a significant drop in real wages—as much as 40-60 percent.

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<sup>34</sup> Many of these may now be in the underground economy, dealing with black market trade, and other illegal pursuits and/or providing black market goods, and not chose to participate in the formal economy.

By 1998-2000, almost all countries in transition had unemployment rates above 10 percent while few had reported any unemployment before 1990. One of the highest reported rates was in Slovenia in 2000 with 18.7 percent. This is combined with high rates of labor inactivity: in the case of Slovenia, just over 50 percent of the potential male labor force was working in 2002 as compared to over 60 percent in most countries. Poland and Hungary also show relatively low rates of activity by males.

- Unemployment Benefits

Income support to the unemployed was an important priority in the early period of transition and the first line of defense to counter slow job creation. Most countries in transition either already had, or quickly put in place, programs for the unemployed. Romania created an unemployment scheme in 1991. But most countries made the early mistake of providing too generous support. In the case of Poland, its program initially included unlimited benefits in terms of time, and support even if the person had never worked. Most of these programs soon proved to be unviable as the state's finances deteriorated with the decline in production that accompanied the initial years of transition. Countries then had to cut back benefits. Relative to the beneficiaries' previous salaries, as of 1997-98, the benefit replacement rate, nevertheless, was still quite high, about 40-60 percent in most Central European countries, with Poland having the highest at 64 percent.

An exception was Estonia that set its benefit rate at 60 percent of the minimum wage or about 10 percent of average wages. Estonia also had a much shorter duration of benefits, only 3-6 months, as compared to up to two years in some others such as Slovenia and Poland. Poland has now reduced benefits to one year. Many others have taken similar steps, typically setting benefits to a maximum of six months. At the same, unemployment benefits have been reduced in real terms and most now are close to the minimum wage. Interestingly, Estonia's poverty rate as of the mid-1990s was a relatively low, at 9 percent of the population. Like many others, Romania revamped its unemployment scheme in 1999: the benefit level is now set at 75 percent of the minimum wage, and granted for 6 to 12 months. In addition, severance payments are made to employees dismissed collectively.

There is much that Cuba can learn from the experiences of these countries in how to confront the problems of unemployment and job creation. The general criticism of the earlier schemes was that high levels of benefits reduced the incentive to search for a new job, allowing the unemployed to be choosier about what job they would take and less active in searching for employment. In addition, it is not clear that countries paid sufficient attention at the early stage on establishing the conditions to encourage job creation: namely, almost all imposed high payroll taxes (including mandatory contributions to pension and health insurance), as much as 50 percent of wages in the case of Romania. Moreover, labor regulations on matters such as working hours, sick leave, layoffs, contracting forms, etc, dampened job creation in the formal sector.

Most importantly, since unemployment benefits were not means-tested and paid out of the budget, at least until insurance contributions could cover outflow, it may have been better policy for countries in transition in the early stages to spend less on cash transfers for the unemployed and more on income support targeted to the poor. This could have happened in conjunction with active policies such as retraining, conditional transfers tied to other merit goods and/or work-fare as Poland and some countries in Latin America have done (see Box 7).

**Box 7: Active Labor Market Policies**

Since 2002, Poland has expanded considerably the array of labor programs to enable and encourage people to find jobs via its “Jobs First” program. These programs include individual counseling, group counseling, career information, job workshops, exchanges and fairs. It also includes training, job clubs, training financial assistance, loans, public works, and other special programs. Poland emphasizes wage subsidies for public works available to local level governments, discounts for hiring unemployed workers by as much as their unemployment benefit, school leaver programs that provide recent school leavers with scholarships to enter certified programs and subsidized loans for hiring the long term unemployed. Studies are mixed on the results of these programs. As with all wage subsidy programs, there is a concern about deadweight: some firms would have hired the person anyway. Some studies indicate that targeted programs on school leavers are effective. Some indicate that general programs may in fact harm a participant’s chance of finding employment. On the other hand, work-fare programs in countries in Latin America (for example, Argentina’s *TRABAJAR* program) have been quite effective in generating temporary employment, with very good targeting and some attendant benefits on future job prospects. In the case of Chile, programs aimed at youths have helped and, in Mexico, training programs have increased chances of employment.

**Source:** The Challenge in Poland: Policies to Raise Employment, by Andrew Burns and Przemyslaw Kowalski, Economics Department Working Paper, No. 414, OECD, December 2004. Pooling, Saving and Prevention: A Comprehensive Insurance Approach to Social Risk Management, by Truman Packard, En Breve, No. 38, World Bank, January 2004.

- Pension Schemes

Another issue that emerged in countries in transition was how to manage their pension systems.<sup>35</sup> This is a serious problem for Cuba, too, and many others in Latin America that have difficulties financing their pension systems.<sup>36</sup> In countries in transition, with inflation and as wages went up in the economy so did indexed pension payments while the economy was shrinking and contributions were falling. Moreover, even before transition, pensions were already putting stress on public finances so that when tax revenues declined, pensions became a very large share of public spending, squeezing other expenditures and inhibiting more equitable social programs. Most countries in transition thus faced dual problems: how to manage mounting pension payments and how to put the system on a viable path, addressing long-standing issues of high replacement rates, low retirement ages, increased life span, special provisions and abuses that made pension systems very costly. These structural problems are in fact common to many countries, including Cuba, that rely on a pay-as-you-go system.

<sup>35</sup> See “Pension Systems Challenged”, press release, Conference on European Pensions, World Bank, Munich, February 2002.

<sup>36</sup> See “Desarrollo social, reforma del Estado y de la Seguridad social, al umbral del siglo XXI” by Carmelo Mesa-Lago, CEPAL, Serie Políticas Sociales, No. 36, CEPAL, January 2000.

Poland typifies the problems faced. It offered one of the most generous pension programs of all of the countries in transition. Contribution rates (payroll taxes) had increased from 25 percent in 1981 to 45 percent in 1990 and could not be increased further. By 1994, Poland was devoting over 15 percent of GDP to pensions of which over 3 percent of GDP was spent on disability payments to mainly middle income groups, representing only 13 percent of working age person, the highest among OECD countries. One of the reasons was the expansion of the eligible beneficiaries during the early years of transition using early retirees to downsize the public sector. Another was the high replacement rate, 64 percent of average wages as compared to about 40 percent in the USA. Full indexation of pensions to price changes also led to rapid increases in payments. Poland was not alone. Slovenia and Slovakia also spent 13 percent or more of GDP on pensions during the 1990s. In the case of Russia, the fiscal effort to finance pension payments remained relatively steady—about 15 percent of the total budget—but it dropped to about 4.5 percent of GDP in 1996, as compared to 6.9 percent in 1992.

Rather than address the root problems, the initial reaction in many countries in transition was to adopt ad-hoc, stop-gap measures. In the case of Poland, this included reducing benefits for special groups, lagging indexation so that benefits rose more slowly than prices, changing the wage base for calculating pensions and reducing the minimum guaranteed benefits. However, since cuts were applied across the board, the decline in the real level of pension benefits had negative impacts on the poor, especially women living alone. In some extreme cases—for example, Albania—women over 65 years of age were excluded from receiving benefits. In Russia, pensioner women were more likely to be living alone and had a poverty rate 30 percent higher than elderly males.

Systemic pension reform has proven difficult. Only in 1999 did Poland launch a new pension system the result of 5-6 years of outreach and consensus building.<sup>37</sup> Bulgaria, too, had since adopted a more comprehensive reform package: the idea, launched in 1999, was that the mandatory pay-as-you-go system would stay in place, as one pillar scaled back over time, while new entrants to the labor force would participate in regulated plans. The option of voluntary participation in fully capitalized plans was to be introduced as the final step while contributions to the original program are reduced.

Looking at the basic parameters, one starts with the conviction that everyone should have access to retirement income in one form or another with the goal of the system to smooth consumption by the elderly.<sup>38</sup> A public pension system should have a distributional element to protect those elderly not able to earn—and thus save—as much as others. The new system would have to take into account demographics, changes in life expectancy and declining fertility rates that have affected all countries in transition and beyond: there should be generational equity with each generation trying to cover its own costs. Multiple instruments may be needed to address the needs of the lifetime poor and

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<sup>37</sup> See “Case Study 4—Poland: Participation in Macroeconomic Policy Making and Reform”, by Madalene O’Donnell and Parmesh Shad, Social Development Note, World Bank, March 2003.

<sup>38</sup> For a broad discussion of the premises and principles of pensions, see Part I, “Old-Age Income Support in the 21<sup>st</sup> Century: An International Perspective on Pension Systems and Reform”, by Robert Holtzmann et al, World Bank, May 2005.

informal sector workers, separate from the needs of formal sector workers. A study on social risk management in Chile showed that people use diverse means to save for their future retirement, with owning their own home as one of the main means.<sup>39</sup> Thus, the pension system should be graduated and it should be integrated with life-cycle savings.

These principles point to some form of non-contributory basic system for the elderly poor that Cuba could consider. It also points to a good system based on voluntary contributions and avoidance of mandated systems that add to labor costs and form an obstacle to the increased formalization of the labor force. Maximum mandated replacement rates should be modest aiming to emphasize the distributional effects and risk-pooling among contributors. There should be mobility: that is, participation should not be tied to particular employers or sectors. With these principles in mind, most countries in the world have a long way to go. Many, such as Poland and Bulgaria, highlighted above, are in fact working towards diversified, multi-pillar systems that shift a share of contributions from the public budget to defined contributions by individuals.

- Social Safety Nets

A serious deficiency, and why unemployment benefits and pensions were initially so important in countries in transition, is that most of these countries did not have effective programs of social protection at the outset.<sup>40</sup> And, even if they did, they devoted a low share of GDP to them. In the early 1990s, Bulgaria, for example, had a well developed system of pensions, very little social assistance and no unemployment benefit.<sup>41</sup> This is also likely true of social protection programs in Cuba. Little known is about their breakdown and target populations.

It is important to emphasize that both pension payments and unemployment benefits, while not targeted to the poor, were important to protect the poor in countries in the early stage of transition that lacked other means of income support to the vulnerable. In the case of Poland, as of 2002, unemployment benefits were a relatively significant source of income for the poorest segments. On the other hand, pensions in Poland also represented a much greater share of the incomes of middle-income groups. This was especially true of disability pensions, as noted earlier. As expected (since pensions are based on prior incomes and contributions), the richest segments of Poland's population received the highest pension payments, even though these payments did not represent as significant share of their total income as for the middle income.

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<sup>39</sup> See "Pooling, Saving, and Prevention: Mitigating Old Age Poverty in Chile", by Truman Packard, Policy Research Working Paper No. 2849, World Bank.

<sup>40</sup> For a discussion of social protection programs in the CIS, see "Social Protection in low income CIS Countries" by Anton Dobronogov, Background paper, CIS-7 Initiative, World Bank, January 2003. Social Sector Reform in Transition Countries, by Christian Keller and Peter Heler, Finance and Development, Volume 38, No. 3, IMF, September 2001, also provides an overview of the challenges.

<sup>41</sup> Social protection in Bulgaria has been reviewed in "Social Safety Net and the Poor during the Transition: the Case of Bulgaria" by Fareed Hassan Jr. and Kyle Peters, Policy Research Working Paper, No. 1450, World Bank, May 1995.

At the start of transition, some countries introduced universal family or child benefits while others introduced new targeted programs, and still others, because of fiscal constraints, had to cut back on their pre-existing child payments. Universal family allowances had been the mainstay of social safety nets before 1990, and the second largest cash transfer, next to pensions. In Hungary, these payments were quite high, as much as 25 percent of average earnings. The idea had been that, if incomes were set by the state, the main differential between the poor/less rich and the less poor/rich was family size. Benefits varied according to the number of children, presence of a single mother, and location. (It is true today that the family size can be an important variable to explain poverty. Some 30 percent of the total poor in Eastern Europe are children.) In addition, countries in transition had programs that offered in-kind benefits (e.g., meals, food vouchers, subsidized heat and utilities, etc). Eligibility for many of these benefits was based on being part of a defined group or category, that is, children, the elderly, disabled, military veterans, etc., and not on means tests.

By the early 1990s, most countries in transition started to broaden their cash income supplement programs, focusing on those who were not covered by unemployment programs or for whom family allowances and pensions were not enough. The direction throughout the 1990s has been towards a guaranteed minimum level of income as in the case of Bulgaria and Romania: more correctly, beneficiaries were income tested as part of the screening system, without actually “guaranteeing” a specific income level. The conceptual underpinnings for these programs are solid but they have encountered considerable difficulties in implementation and are not necessarily well targeted. However, there is growing evidence that transfers—if well targeted—have contributed to reducing income inequality in countries such as Latvia and Bulgaria.<sup>42</sup>

One of the first concerns in most countries in transition has been the low level of coverage of targeted programs, that is, errors of exclusion under which many eligible people do not receive benefits. The next concern was the level targeting efficiency: evaluations in the first part of the 1990s showed that poverty programs were not particularly well targeted, that is, there were high level of errors of inclusion or people who benefited but should not have. In Russia and the Ukraine, the poor actually received very little in terms of social assistance programs, while countries like Hungary and Bulgaria performed considerably better. Romania’s minimum income guarantee (MIG) program, which evolved and expanded during the 1990s, devotes 62 percent of its resources to the bottom 20 percent of the population, one of the best performances in the region, and is very good at reaching the extreme poor. Nevertheless, that program only reached 3.9 percent of the total population or roughly half of the poorest 20 percent. Even now, in Poland, the highest income earners receive high levels of social assistance—almost the same as the poor. Another concern has been the capacities of local administrations (municipalities) to implement the programs, This too is a problem

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<sup>42</sup> See “Dynamics of Income Inequality and Welfare in Latvia in the late 1990s” by Hippolyte Fofack and Celestin Monga, Policy Research Working Paper No. 3336, World Bank, June 2004. The same conclusion was expressed in the case of Bulgaria; see “Bulgaria: Poverty Assessment”, Report No. 24516-BUL, World Bank, October 2002.

being addressed in the case of Chile. Cuba would clearly have opportunity to do better on targeting and achieving coverage of its social protection programs.

- Enhancements to cash transfers

Many countries in Latin America, dealing with their own economic dislocations, chronic unemployment and poverty, have developed variations to cash transfers. Cuba could easily adopt such programs. Work fare, that is, programs under which beneficiaries perform some social service while receiving a minimal level of income have proven very effective in targeting and generating public goods. One of the best examples, mentioned earlier, is the *TRABAJAR* program in Argentina.<sup>43</sup> This was a self-targeted program, that is, participants have to come forward; they only earned somewhere close to minimum wage and had to work some 20 hours per week. Their labor was directed to maintenance of public facilities such as schools, health clinics, drainage, public housing, etc., that have externality. The program was originally patterned after the successful social investment funds seen in many low income countries where formal employment opportunities are rare. Self-selection lowers administrative costs and can achieve high levels of targeting.

**Box 8: Costa Rica's *Supermonos***

*Supermonos* is a cash transfer program that provides poor families with a subsidy for the purchase of food, conditional upon children regularly attending school. All children between ages 6 and 18 years in the family have to attend school, and if they do, the family obtains a coupon worth about US\$10 per month. Beneficiaries must pass a proxy means test, as required for all social assistance in Costa Rica, dependent on the occupation of the head of household, the quality of housing, household incomes, net worth, and educational attainment of the head of household. Based on a recent evaluation, the program has been shown to be very effective in achieving its goal of increasing school attendance: beneficiaries are between 3 to 9 percentage points more likely to attend school than those not participating. Given the already high rate of enrollment, this increase is significant. There was no impact on the level of attainment by these students, nor did it necessarily reduce child labor. The latter effect has been shown to result in Brazil and Mexico if the requirement is to attend later school programs, combined with measures to reduce child labor. **Source:** The Effect of Conditional Transfers on School Performance and Child Labor: Evidence from an Ex-post Impact Evaluation in Costa Rica, by Suzanne Duryea and Andrew Morrison, Working Paper 505, IDB, February 2004

Another development is the use of conditional transfers, now common in Latin America such as Argentina, Brazil, Nicaragua, and Mexico.<sup>44</sup> Evaluations, for example of Costa Rica's program, *Supermonos* (see Box 8), show that these programs can be effective in promoting human capital formation among poor households: some of the benefits include increasing enrollment rates, improving preventative health care and raising household consumption. Families receive benefits as long as they comply with requirements for certain public goods, namely, immunization, prenatal care, post natal care, after school programs, school attendance, and nutritional supplements.

<sup>43</sup> See "Third Social Protection Project: Implementation Completion Report", Report No. 26134-AR, World Bank, June 2003.

<sup>44</sup> See "Evaluating the Impact of Conditional Cash Transfer Programs: Lessons from Latin America" by Laura Rawlings and Gloria Rubio, Policy Research Working Paper, No, 3319, World Bank, August 2003.

The design of social protection systems is complex and needs to evolve over time. The latest steps taken by Chile offer an example for Cuba to consider on how an already good system can be improved and become increasingly integrated and focused on the hard core poor (see Box 9). Chile is in fact one of the best cases in Latin America of a country that has been able to reduce poverty during the 1990s. Unfortunately, income inequality remains high.<sup>45</sup> Countries in transition have been making gains too as demonstrated in both the decline in poverty rates in the high performing countries and the growing effectiveness of their social protection programs.<sup>46</sup> There has been considerable progress made in these countries, starting from a very low base.

**Box 9: Chile's Solidarity Program**

During the 1990s, Chile achieved substantial reductions in poverty, with the country's poverty rate declining from 39 percent in 1990 to 20 percent in 1999. Sustained high growth was mainly responsible for this, but increased spending on social programs has been another reason: social spending increased at the rate of 8 per cent per year and helped to offset deterioration in income inequality. Generally, Chile's targeted social programs are considered quite effective yet poverty analysis by the World Bank in the late 1990s revealed that some programs had high leakage (errors of inclusion) and little coverage (errors of exclusion). Moreover, when the rate of growth slowed, so did the rate of poverty reduction. Authorities wanted to do more. One of the areas scrutinized was the method targeting the poor. Chile has long been using targeting device called the *Ficha CAS*, for determining eligibility for all social programs, based on regular household surveys and core demographic, housing, educational, and other data that correlated with poverty in the country. However, data were outdated, administrative processes bureaucratic, and data not cross-checked. Most importantly, the system did not seem to identify the most extreme cases of poverty and it was passive in gaining access for these people. Started in 2002, the Solidarity program aims to change this: it focuses on the family as a unit; it has an outreach program to connect these families to the social safety network; it provides integrated access to social assistance and cash transfers; and it eliminates regional rationing and quotas that had been a feature of the earlier resource distribution system. Participating households now receive a new conditional cash transfer while social workers work with the family to identify its needs in seven areas: health, education, employment, housing, income, family life and identification. Impacts so far show that this new approach has been effective in coordinating national and local agencies and motivating women. However, empowerment of the poor, that is, their ability to network and to take charge has been slow.

**Source:** Project Appraisal Document, Proposed Social Protection Technical Assistance Loan, Report No. 27247-CL, World Bank, November 2003; Antecedentes generales del Sistema de Protección Social, Chile, [www.mideplan.cl/publico/ficha\\_tecnica](http://www.mideplan.cl/publico/ficha_tecnica), 2002

- Targeting Alternatives

Targeting remains an issue: most programs in countries in transition continue to have high errors of inclusion and exclusion, and targeting can be hard especially if reliable data on incomes and consumption are not available, as highlighted earlier. However, much has been learned in Latin America, countries in transition and elsewhere, on how information on social conditions can be used to target beneficiaries and monitor

<sup>45</sup> See "Successes and Failures in Poverty Eradication: Chile" by Alejandro Foxley, Case study, Conference, World Bank, Shanghai, May 2004.

<sup>46</sup> Many of the World Bank's country poverty assessments show that the high performing countries are more able now to address poverty at the same time as the nature of poverty in these countries has evolved to more extreme poverty among particular groups such as the Roma, the homeless, isolated rural populations/micro-communities, large families, and so on. See Romania: Poverty Assessment (2003), Hungary: Long Term Poverty, Social Protection, and the Labor Market (2000), and Poland: Employment and Living Standards in Pre-Accession Poland (2004).

impacts. The current literature rarely advocates verified means tests, due to high administrative costs and lack of suitability especially if the informal economy is significant.<sup>47</sup> Many countries are, instead, moving towards country/segment specific proxies to determine eligibility for social assistance using data collected on household consumption, characteristics, and living standards. Through statistical analysis, a country can identify the particular attributes of a household that are most closely associated with poverty. This approach can be adapted to specific groups or locations, for example, and achieve quite high rates of predictability. In the case of countries in transition, the presence of easily identifiable consumer goods such as a color TV, a car, a washing machine, etc, can be robust predictors of the poor and non-poor.<sup>48</sup> Geographic location, the number of children, the age and level of education of the head of households, and housing conditions can also be variables used to predict poverty. Social auditing by communities and non-governmental organization can complement these measures and have proven to be effective in increasing transparency and reducing fraud.

- Affordability

Adequate funding of the needed social safety net is still a concern, as the poverty gap in many countries in transition remains large, requiring some 9-10 percent of GDP to close fully. While most OECD countries spend some 0.5 to 1.25 percent of GDP on social assistance, countries in transition have been spending up to 2 percent of GDP or even more. Romania's MIG program only accounted for 0.3 percent of GDP in 2002 but has since been increased to 0.6 percent, the same level as the child allowance program which is not targeted. Thus, more effort could be made to focus these resources to the poor: the public resources devoted to pensions remain extremely high, offering room for redeployment to programs with greater impact on the poor.

Expanded social protection programs would be more affordable if the production shock, experienced by most countries at the outset of the transition, were reduced, thus restoring public finances more quickly. Eastern European countries that followed more aggressive reform programs, avoided conflicts, and have less entrenched Soviet legacies, were able to shorten the negative production effects, reaching the bottom about 4-5 years after the start of transition, while those in the CIS lagged and took twice as long.<sup>49</sup> In the case of Cuba, it is debatable how much of a production shock the country could face with a transition to a more open market-based economy: some say that Cuba has already experienced the worst during the special period in the early 1990s. If that were to be the case, then public finances would be less of a constraint. Regardless, Cuba should think of devoting a sizeable amount to targeted programs: that could easily be 2 percent of GDP as is the case of many countries in transition.

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<sup>47</sup> See "Implementing Household Targeting: Lessons from Latin America and the USA", presentation, World Bank, November 2003.

<sup>48</sup> See "Poverty Correlates and Indicator-Based Targeting in Eastern Europe and the Former Soviet Union" by Christiaan Grootaert and Jeanine Braithwaite, Research Project, RPO-680-33, World Bank, May 1998.

<sup>49</sup> See "Who is Still Haunted by the Specter of Communism? Explaining Relative Output Contractions Under Transition", by Julian Berengaut and Katrin Elborgh-Woytek, Working Paper, No. WP/05/68, IMF, April 2005.

## Access and Quality of Health and Education

Cuba starts from an enviable position in terms of the levels of access and quality of its educational and health care systems. Every effort should be made to preserve these accomplishments. Many countries in transition were in a similar position in 1990. Access to health and education was universal and services, free. In education, adult literacy was almost universal; participation and completion rates in education for children and youths of both genders were high; teachers came to work; students had books, and repetition and drop out rates were low. In health, life expectancy had increased; infant mortality was low; virtually all children were immunized; malnutrition was low; and communicable diseases, controlled. The major disease burdens were life-style related and similar to those faced in higher income OECD countries: lung cancer, liver cirrhosis, cardiovascular disease and injuries.

- Signs of Stress

Social services came under stress during the 1990s and inequalities grew during the transition. These problems were coupled with the inefficiency and technical deficiencies that are part of the legacy of the control-and-command system that point to the need for reforming these bureaucracies. Cuba could therefore usefully anticipate the same sorts of problems in health and education and work to minimize the negative impacts. It should further be noted that the management of social services, particularly health, is proving to be a challenge in many countries—developed and developing. Thus, there is an array of experiences to draw upon and Cuba would not be alone in attempting to reform its social services while improving outcomes.<sup>50</sup>

Generally, countries in Eastern Europe, as compared to those in the CIS, were better equipped to avoid some of the problems and to react expeditiously. As a result, for Eastern European countries, the level of deterioration in the quality of social services and outcomes in both health and education seems to have been relatively modest, as compared to long term trends, and/or had been relatively short lived and overcome with time. Health indicators for 2000/2001 in countries in Eastern Europe show continued high rates of immunization and enrollment, coupled with low levels of low birth weight babies and HIV, for example. While, indeed, progress stalled during part of the 1990s, it has not been abandoned: indicators reveal considerable improvement since 1980, and even since 1990, in some cases.

Looking specifically at education, the main deterioration was the decline of enrollment in pre-schools and secondary schools.<sup>51</sup> Countries in Eastern Europe were able maintain enrollment in basic/primary education (mandatory) but almost all countries in transition saw declines in secondary education (non-mandatory). Enrollment in tertiary

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<sup>50</sup> For a look at reforms in the health sector, see “Health-Care Systems: Lessons from Reform Experience”, by Elizabeth Docteur and Howard Osley, OECD, December 2003

<sup>51</sup> See “Improving Capabilities: Education, Making Transition Work for Everyone”, World Bank, 2000

education displayed various patterns: in some cases, such as the Slovak Republic, enrollment increased, as students saw little point in entering the labor market, and in some it declined, especially among the poor. Pre-school was also affected: in some countries, pre-school (or day care) was provided by state owned enterprises and when they could no longer afford to provide this service, the only option was to charge users, whether provided by the enterprise or the municipality or a private operator. In the case of health care, the situation has been similar. There was a decline in life expectancy in Russia although the reasons for this are quite complex; there was also some evidence of increased malnutrition and spread of communicable diseases.

- Improving Efficiency without Compromising Quality and Equity

One of the challenges faced by countries in transition was maintain public funding for all programs in light of declining revenues. Generally, countries in Eastern Europe were able to do this: as of 1998, for example, these countries spent an average of 4.4 percent of GDP on education as compared to 4.9 percent among OECD members and 4.1 percent in Latin America (as of 2000). As a result, for Eastern European countries, the main issue in the social sectors has not been the total level of funding, but the distribution of those resources among competing demands. In practice, most countries protected employment, thereby keeping payrolls high, while limiting individual wage increases and squeezing funds for materials and maintenance. Importantly, it should be noted that Cuba already spends considerably more than Eastern European countries on health and education and may thus confront more serious resource problems depending on the production shock that it would experience.

Nevertheless, despite the strains on public financing, there is little evidence of massive restructuring in the social sectors that might have been anticipated at the outset of the transition process. A few countries actually increased employment in the social sectors during the 1990s, as an offset to greater unemployment in the economy. The effort to protect employment in the education sector can be demonstrated by the continuing decline in the student-teacher ratios: they already were low and went even lower. Using OECD standards as a benchmark, about 1/3 of the education labor force could be considered redundant. In the case of health, the situation is similar. Again, most countries have been able to maintain total spending, but at the expense of certain categories, especially drugs. So far in health, in contrast to education, there is some evidence of restructuring in countries in transition: the average number of beds has been falling and the number of doctors, in the Czech Republic, fell while their wages kept up with overall wage increases. In some cases, greater decentralization, such as in Hungary, resulted in more responsibility shifted to local governments, with a higher prevalence of cuts in poorer regions than richer ones.

A full description of what works best to restructure the health and education sectors is beyond the scope of this paper and warrants further study. In the case of education, it is known that the quality of schools is only one of the factors affecting student attainment; family background and environment are also very influential and have to be taken into account. In addition, a main determinant of educational attainment has

been found to be teacher effectiveness and there is a body of literature that focuses on teacher incentives, cognitive skills, and motivation. Experience in Mexico, for example, shows that higher student outcomes are linked to compensation based on teacher performance evaluation and demonstrate that there is room for change.<sup>52</sup>

In the case of health, reforms have been slow and contentious.<sup>53</sup> The central issues are dealing with excess hospital capacity, securing viable financing programs, controlling expenditures, and ensuring quality services, while avoiding predatory behavior, moral hazard and conflict of interests. A significant problem has been the emergence of a dual system: one operated by the state and the other offered in private by the same medical professionals, facilitated by the short working shifts in public facilities. Some countries have put in place health insurance schemes for formal sector workers, but there have been problems in putting them on a sustainable footing with many issues yet to be resolved. An effective way of reducing health costs has been to encourage outpatient settings and to shift from specialists to family practitioners as being done in Poland.

- Cost Recovery

Importantly, the uncontrolled or planned emergence of dual practices, user fees, co-payments and informal payments for service occurred during the 1990s, as public resources were scarce and wages fell.<sup>54</sup> Cuba should try to prevent this development during a transition if it can. The problem has been much more pronounced in health than education and has been particularly debilitating on the poor, exacerbating problems regarding access and quality of services. Surveys in Armenia, for example, show a 12 percent reduction in use of health service, and almost twice that among vulnerable groups.<sup>55</sup> In that case, even the offer of free services was not sufficient to stem the decline in usage.

While shifting some costs to users, depending on the system and how costs are pooled, is not necessarily bad, the uncontrolled rise in payments affected access by the poor to social services. Part of the problem has been the result of decentralization efforts that transferred responsibility for education and basic health, among other things, to municipalities that were not adequately funded (see the next section). In addition, many countries—Bulgaria, Lithuania, Poland, Romania, and Slovenia—introduced health insurance for formal sector workers that added to the burden on the employer, and not the employee, and may have hampered job creation, as discussed earlier.

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<sup>52</sup> There is much contention about the appropriate level of teacher remuneration. A recent study by CEPAL indicates that compensation varies. As an average in Latin America, initial secondary teacher salaries are the equivalent of 1.2 times per capita income, as compared to an average of 1.0 times per capita income for developed countries. Mexico, in particular, had relatively high 1.6 times per capita income.

<sup>53</sup> See “World Bank Health Projects in Eastern Europe: An Evaluation:”, excerpt from “Supporting Health Reform in Eastern Europe”, Newsletter No. 223, OED, summer 2002.

<sup>54</sup> See “Who is Paying for Health Care in Eastern Europe and Central Asia” by Maureen Lewis, World Bank, September 2000.

<sup>55</sup> See “The Effects of a Fee-Waiver Program on Health Care Utilization among the Poor: Evidence from Armenia” by Nazmul Chaudry, et al, Policy Research Working Paper, No. 2952, January 2003.

Of most concern has been the demand to make informal payments to hospital administrators, doctors and other health professionals. Such payments were required to ensure access to health services, in contrast to voluntary gratuities once service were provided—also reported to be a frequent practice. Informal payments are said to be common in most countries in transition, with the exception of Slovenia and the Czech Republic. The occurrence of these payments varies from as low as 20 percent to over 90 percent of health services depending on the location. These payments have impeded access to health services, especially by the poor who cannot afford them, and account for increased out of pocket spending in Poland and Hungary, for example. Research on this problem offers a number of suggestions on how to avoid such practices.

- Management and Monitoring

Part of the remedy to sector inefficiencies which Cuba shares is to alter internal management and increase monitoring and evaluation. This can be done by adding elements of choice and benchmarking, so users are informed and not captive of a particular service provider. In health, the system can be organized into a number of providers and, in education, mobility across school units can help. Chile provides a good example of choice among schools.<sup>56</sup> There also need to be systems to collect data on attendance for example and of evaluating results and monitoring progress, including standardized tests to enhance learning. In health, there needs to be systems to set service standards, audit results, educate the public, publicize policies, and provide avenues for redress. Generally, both health and education systems benefit from increasing autonomy and accountability via improved management systems. In the case of education, the *EDUCO* Program in El Salvador is a good example of increased parental involvement in school administration (see Box 10). It should be noted that progress has varied across countries in transition: as of 2002, Bulgaria still did not have a system to control drug prescriptions or improve prescribing practices.

**Box 10: El Salvador's EDUCO Program**

Starting in the early 1990s, El Salvador's Education with Community Involvement program transferred resources and decision making to schools and empowered community groups. Now about 40 percent of all rural schools are managed in this way. Rural enrollment, offering pre-school and basic education, has expanded. There has been no compromise on quality: rural students in EDUCO schools in the poorest areas perform equally as well as students from better off areas. Teacher absenteeism is down. Learning time has increased. Innovations have been introduced including multi-grade classrooms and accelerated education. EDUCO schools are more efficient than traditional rural schools and have more teaching materials. Under EDUCO, teachers are hired and paid by the community, with teachers' job security and pay depend on performance as assessed by the community. The community manages the resources provided by the government which also provides support to communities and training. This has aided social capital in these communities. The program's success is attributed to strong leadership and commitment by authorities and communities, capacity to innovate, and access to support.

**Source:** EDUCO: A Community Managed Education Program in Rural El Salvador (1991-2003), En Breve, June 2004, No. 51, World Bank; El Salvador's EDUCO Program: A First Report on Parent's Participation in School-based Management, Evaluation Team, Ministry of Education, El Salvador, July 1997

<sup>56</sup> See "Chile: Mas de Diez Anos de Reforma Educacional" by Lauritz Holm-Nielsen and Juan Prawda, En Breve, No. 44, World Bank, March 2004, and "School Choice, Student Performance, and Teacher and School Characteristics: The Chilean Case" by Emiliana Vegas, World Bank April 2002.

- Adequate Funding Mechanisms

Part of the solution to improving efficiency, equity and quality in the social sectors is to establish good ground rules for the distribution of budget resources and to reduce the urge to increase public employment in these sectors. Mistakes were made in the case of decentralizing education to municipalities in some countries in transition (see subsequent sections). Rules need to focus on results, rewarding efficiency, yet adjusting for inherent characteristics of the populations being served. Per capita funding, adjusted for health risk and family background, is one way to do this as shown in the case of Costa Rica (see Box 11). Capitation health payments in Poland, for example, have promoted cost-effectiveness and reduced the role of informal payments. In addition, several countries in transition, including Bulgaria, have set up independent health insurance agencies to separate funding from service delivery. Cost recovery has been introduced, at least for formal employees and employers, with fees averaging 13 to 16 percent of gross salaries. If user charges have to be introduced, they should concentrate on areas in which public goods are less at stake and where private returns are more prevalent; in the case of education this would be tertiary education and in the case of health, it would be elective treatments and/or to encourage lower cost treatments (e.g., the use of generic drugs).

**Box 11: Costa Rica: Health Policies**

The health system in Costa Rica has evolved with different models and reforms over the years. It is now a mixed public-private system. Most importantly, it has been transformed from a supply based system to one based on population. It has introduced performance contracts with health providers and established a clearer division of responsibilities among institutions. At the same time, public health spending has dropped since 1990 to 5.3 percent of GDP, down from 6.7 percent. Spending has increased for the poor and for primary care and has been reduced for specialized and hospital care by substitution with lower cost care. The mainstay of the system is the centrally managed public health insurance plan. But there are elements to encourage private sector companies. Since 1990s, the system has shifted to family care physicians put in charge of patient arrangements who form part of the privately managed cooperatives that provide health services to the community and are paid on a capitation basis. The country is divided into health care areas, averaging about 45,000 persons, with health teams dedicated to providing specialized and primary service to that particular population. Since 1990, Costa Rica's health indicators have continued to improve.

**Source:** Costa Rica: Health Policies, by Angela Lisulu, Background paper, World Development Report 2004, World Bank, September 2003

Finally, an important dimension is to compensate for any changes in incentives and cost recovery in the social sectors with transfer programs targeted to vulnerable groups. This can be done in many ways—fee-waivers, comprehensive health insurance, and income support payments. As described in earlier sections, there are ways in which conditional cash transfers can enhance education and health outcomes at little extra direct cost to those sectors. In addition, co-payments can be waived for the poor and/or fee schedules set low for a basic package, with waivers applying as needed for more complex treatments. It will be important for Cuba to protect pre-school education, as this is one of the areas where cost pressures may reduce enrollment. Equally important in the case of Cuba will be to retain youths in secondary school and to expand access to tertiary education which is currently relatively low, only some 25 percent of the eligible population (as of 2001), as compared to about 40 percent in Chile. If there has to be

increased cost recovery in areas such as tertiary education, there should be compensation to facilitate access for the poor.

### Quality of Public Institutions, Rule of Law, and Anti-Corruption

The fifth challenge that countries in transition have had to face is the transformation of command and control, state-oriented authoritarian structures to a more client-oriented public administration, governed by a set of rules that establish rights, coupled with a democratically representative legislature and an independent judiciary. This is a tall order. Given the lack of detailed information available on Cuba's public administration, it is difficult to predict the extent and nature of the problems that its public sector may face during a transition. But, judging from the experience of Eastern Europe, it is likely that the transition will be significant. The main problem is the lack of market institutions and knowledge about how markets work—and how markets can fail—along with bureaucratic systems based on power and political influence. Moreover, countries in transition lacked the institutions and policies to promote redistribution within society, using taxes, transfers and other public policies to promote social justice. Finally, political and administration structures did not have countervailing forces such as civil society organization and an independent press and were not accustomed to dealing with criticism and debate in a pluralistic society.

For those countries in transition wishing to accede to the European Union, there has been a clear benchmark: the public institutions for new members were to function at the same level as those of existing members in terms of reliability, transparency, predictability, accountability, adaptability and efficiency. These attributes must be embedded in political and administrative institutions and processes at all levels and they must be defended by independent control bodies, systems of justice and parliamentary scrutiny and by opportunities for voice and redress by citizens. Considerable assistance was financed by the EU to countries in transition in order to set the stage for accession.<sup>57</sup> It is not likely, however, that Cuba will find itself in the same situation because of the lack of a similar regional thrust. Nevertheless, regional organizations such as the IDB and the OAS could be important sources of advice and support.

Performance in improving institutional capacities has been mixed, with some countries advancing further than others. Most countries have progressed on putting in place democratically elected parliaments, even though many still have concerns about the quality of democracy, especially in the CIS. Many public administrations are fragmented and unwieldy: as of 1998, for example, Romania has 15 ministries, 24 specialized agencies and over 1800 subordinate institutions. Ministries do not communicate with one another, there is rivalry and duplication among units and the lack of coordination is common. There has been a lack of a vision for the public administration, a lack of consensus among stakeholders, and agreement on the shape, costs, and elements of such a program. This situation has been compounded by deteriorating conditions of public pay

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<sup>57</sup> For an example of this work, see “Administrative Procedures and the Supervision of Administration in Hungary, Poland, Bulgaria, Estonia and Albania”, SIGMA Paper No. 17, OECD, 1997

and benefits during the transition: in Romania, by the end of the 1990s wages in the public sector have fallen twice as much as those in other sectors. Size is not necessarily an issue and not all countries have excessively large bureaucracies: in the case of Bulgaria, Estonia, Hungary, and the Czech Republic, for example, the civil service is not out of line with those in OECD countries—or about 7-8 percent of the total population.

Good governance will be important for Cuba as it is for all countries. Studies of governance by the World Bank show that high performing countries in terms of governance are also more likely to have better development outcomes: there are correlates between infant mortality and corruption, literacy and the rule of law, per capita income and voice and accountability and regulatory burden, among others. Research by the Inter-American Development Bank further demonstrates that income inequality has a strong causal effect on the quality of institutions, that is, the pernicious effects of inequality pull down the quality of institutions, more so than the other way around.<sup>58</sup> An explanation that resonates with experience in Latin America and some countries in transition is that the rich have the means and wield strong influence in unequal societies to subvert institutions while the poor have less opportunity to do the same.

Administrative, judicial and political reform in countries in transition is an exhaustive process and not covered comprehensively in this paper. Changes are still slow to evolve with the most success evident in adopting a few core laws to establish basic line conditions for the civil service, attention to core economic management handled by the Ministry of Finance or its equivalent, especially budget management, in conjunction with transformation of individual ministries/function. An important component of this process is to replace the “Party” in the central decision making and coordination role. Only a few dimensions will be dealt with here in more detail, namely, tax policy and administration, decentralization, political institutions, justice and anti-corruption. These areas have particular relevance for social justice and good governance.

- Tax policy and administration

One of the first preoccupations of countries in transition was putting in place a system for revenue collection, taking into account fairness and efficiency. Some countries started tax reform before 1990: Hungary introduced a VAT and personal income tax in the late 1980s, while reducing corporate taxes. On the other hand, Russia did not have personal income taxes and had to start from scratch. Particular challenges for countries in transition have been to: (i) put in place systems to collect from a diverse set of individuals and small firms replacing the reliance on revenues from a few large state-owned enterprises; (ii) reduce harassment that was a feature of the early tax regimes while strengthening enforcement via the use of computers, cross checking of data bases and auditing; (iii) reduce corruption and avoid evasion and favoritism towards elites; and (iv) overcome the culture of mistrust and instill a practice of self-assessment. One of the continuing issues facing countries in transition is how to incorporate the

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<sup>58</sup> See “Inequality and Institutions” by Alberto Chong and Mark Gradstein, Working Paper 506, IADB, April 2004.

informal sector and to put in place a tax system that covers a broad base. Cuba is well positioned on this as it has already started on this process but will face similar challenges.

A study of taxation shows that countries in transition are not that far off from what would be expected given their income levels.<sup>59</sup> While all countries faced a drop in tax revenues and restructured the economy, via privatizations, thus reducing the total size of the state in the economy, the decline has put them on a level on par with their comparators. In the case of Eastern European countries, aiming for accession to the European Union, current levels are to be reduced by about 2 percent of GDP. Such a reduction would bring tax rates in line with rates in countries of comparable income levels, that is, in the range of 33-35 percent of GDP. For these countries, revenue as a share of GDP has already fallen from the start of transition, from 41 percent of GDP to 38 percent of GDP, mainly the result of lower corporate profits (because of enterprise restructuring, closures, etc) and lower taxes on trade as part of trade liberalization.<sup>60</sup>

Tax rates in countries in transition appear within ranges seen in other countries. VAT rates vary between 15 to 23 percent. Personal income tax rates exist in all countries, with the highest maximum marginal rate typically 35-40 percent, but 13 percent in Russia and equally low in several other countries (see below). Corporate profit taxes range from 18 to 30 percent. Over time, there have been shifts in tax burdens, away from corporate profits to consumption and personal income. Little data are available on the distributional aspects.

Despite the early falls in tax revenue, countries in Eastern Europe and the Baltic have been able to maintain relatively high levels of public spending, subject to constraints on the size of the fiscal deficit: average public expenditures represented 41.9 percent of GDP for 1999-2000, implying fiscal deficits in the range of 3 to 4 percent of GDP. This is very similar to the public sector's share of the economy in higher income OECD countries in the same period—42.4 percent of GDP. These countries also show a very close similar breakdown of expenditures as higher income OECD countries although countries in transition spent significantly more on public order and safety, less on social security and welfare and less on interest payments.

Another early measure was to focus collection on large tax payers, a practice encouraged by the IMF since the 1980s.<sup>61</sup> This measure is consistent with best practices in OECD countries which show that segments of the population need different approaches. Large tax payer units have proven an effective means to preserve revenue levels while carrying out institutional reforms that tend to lag policy changes. However, the focus on large tax payers can take away pressure to address other segments, notably, small and medium enterprises, the most dynamic part of these economies. Somewhat

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<sup>59</sup> Generally the share of the economy devoted to taxes correlates positively with the income level of the country. See "Tax Systems in Transition" by Padeep Mitra and Nicolas Stern, Policy Research Working Paper, No. 2947, World Bank, January 2003.

<sup>60</sup> See "The Revenue Decline in the Countries of the Former Soviet Union" by Adrienne Cheasty, Finance & Development, IMF, June 1996.

<sup>61</sup> See "Improving Large Taxpayers' Compliance: A Review of Country Experience", team led by Katherine Baer, IMF, April 2002.

later in the process, countries are now addressing the issue of how to collect social security contributions (health, pension and unemployment insurance).<sup>62</sup> Many countries (Estonia, Hungary, Latvia, Russia, Serbia, Slovenia, Bulgaria and Romania) have taken the approach of integrating the two functions or setting up one agency to collect both.

Russia has possibly undertaken the most innovative tax reform of all countries in transition, patterned after the first move in the direction of flat taxes taken in Estonia in 1994.<sup>63</sup> As of early 2005, about nine countries in transition have adopted flat taxes, with rates varying between 12 percent (Georgia) and 26 percent (Estonia). In the case of Russia, its tax system had been inconsistent, compounded by taxes imposed by different levels of government. If paid in full, taxes would have been excessive leading to invasion. The government may have turned a blind eye to certain sectors, including the important energy sector, and there was evidence of lax and erratic enforcement, with dramatic levels of evasion.<sup>64</sup> Contributions to pensions had been increased, to offset the rise in the informal economy, reaching untenable levels. By 2001, the conditions were ripe for radical reform: Russia introduced a flat tax of 13 percent of personal wage incomes (beyond a basic level exempt from tax). This was part of a large reform package that created a single tax payer identification number, introduced indirect assessments and reduced social security contributions. The immediate effect on collections was significant. But it is hard to determine if this increase in revenues was explained by a general increase in incomes, the drop in the tax rate, or improvements in enforcement.<sup>65</sup> Moreover, the informal sector remains significant.

- Decentralization

Many countries in transition, as elsewhere, have looked to decentralization as a means of bringing public services closer to the people, increasing responsiveness and accountability. There is exhaustive literature on decentralization and experiences relating to increased participation and citizen involvement in local administration and budget decision making: some of the many examples in Latin America come from Brazil. At the same time, some countries have taken advantage of decentralization to reduce fiscal pressures on the center and shift programs to local levels. This was the case of Argentina in the early 1990s. It was also the case in Hungary. Hungary in fact started the process of decentralization in education in the 1970s (as did Argentina).

There has been a downside to decentralization that Cuba could try to avoid. In 1990, both Hungary and Poland introduced major program of decentralization, giving local administrations autonomy and the right to raise taxes while defining their responsibilities for basic education and health, street lighting, road maintenance, social

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<sup>62</sup> See “Integrating a Unified Revenue Administration for Tax and Social Contribution Collections: Experiences in Central and Eastern European Countries” by Peter Barrand et al, Working Paper WP/04-237, December 2004.

<sup>63</sup> See “The Case for Taxes”, The Economist Magazine, April 16, 2005.

<sup>64</sup> See “Economic Crime in Russia” by Gregory Kisunko, Beyond Transition: the Newsletter about Reforming Economies, Volume 7, No. 7-8, World Bank, July-August 1996

<sup>65</sup> See “The Russian Flat Tax Reform” by Anna Ivanova et al, Working Paper, No. WP/05/16, IMF, January 2005.

assistance, and culture, among other things. Hungary's program has been the most extensive, creating some 3169 local entities.<sup>66</sup> This is now considered excessive: administrative costs are high, and economies of scale in service provision such as education have been lost. Local governments fell into fiscal difficulties and by the mid-1990s, Hungary had to impose greater fiscal discipline. Part of the problem was the lack of adequate funding from the center. In Hungary, revenue from personal income tax, motor vehicles and property are shared by local governments and the center. Other revenues were transferred on the basis of earmarked grants and normative grants. The latter was based on per capita funding for education, pre-schools, social protection, etc. However, there was no requirement for the municipalities actually to spend the funds for these specific purposes, nor were the norms particularly equitable. This is thought to be the reason for the increased difficulties in funding education, for example, among poorer municipalities that was cited earlier. Slovakia's experience has been similar: it started a process of decentralization in 1990 and expanded the number of local entities in 1996 exacerbating administrative costs. Mistakes such as providing funding by school instead of by student led to further problems. As a result, more reforms are underway.

- Political Institutions

Obviously a major change in countries in transition has been the political structure, moving from a one-party, non-contested system to democratically elected, multi-party, representative legislatures with separation of powers among the three branches of government. Countries in transition show a wide diversity of electoral systems, using both closed and open lists, pluralities, direct and proportional representation, and presidential structures. The evolution has not always been smooth, with wealth, power and connections still dominant forces, and most countries in the process of democratic consolidation. Cuba should expect to encounter similar challenges.

So far, there is little guidance for Cuba on the forms of democracy as there is no systematic analysis available that relates political models with different economic and social outcomes in countries in transition and elsewhere. A first step to enable such analysis has been the compilation of data on political institutions in over 170 countries by the World Bank.<sup>67</sup> These data cover the electoral cycle, measures of electoral competitiveness, tenure, checks and balances, etc, and can be used to discern if a particular political structure or process is associated with better or worse outcomes, say in terms of budget deficits, corruption, effectiveness of regulations, etc. Research points to concerns about sequencing with the need for market reforms to take hold before, or at least at the same rate as political reforms.<sup>68</sup>

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<sup>66</sup> See "The Effectiveness of Decentralization in Hungary and Slovakia" by Jean-Jacques Dethier, World Bank, IMF Conference on Decentralization, Washington, November 2000.

<sup>67</sup> See "New Tools and New Tests in Comparative Political Economy: the Database of Political Institutions" by Thorsten Beck et al, no date.

<sup>68</sup> See "Corruption and Democratic Consolidation, by Michael Johnston, Colgate University, Revised June 2000.

Managing expectations has been difficult in most countries in transition. The adoption of democracy set high expectations for the economic returns that were not forthcoming in the initial years of transition. Experience also shows that strong institutions are needed to protect expanded participation and to restrain excesses. In practice, democracies evolve as participants learn, with “old” democracies working better than “new” ones, and new democracies experiencing higher levels of rent seeking and corruption and directing public expenditures to the benefit of particular groups. New democracies have been found to spend more on public investment that runs the risk of being clientalist.<sup>69</sup> Voters in new democracies are likely to be less well informed and politicians, less practiced. These lessons point to the need for strong participation and monitoring of political processes by civil society and autonomous institutions.

Looking at what is known about particular democratic forms, preliminary analysis seem to dispel the conclusion that parliament systems fare better than presidential systems. However, a study comparing political systems showed that closed list and open list proportional systems of representation are more susceptible to corruption than plurality systems.<sup>70</sup> Under closed list systems, party leaders rank candidates and voters only cast ballots for a party, while under open list systems, voters cast ballots both for the party and rank the candidates given the list of the party’s selection of candidates. In particular, under closed list systems, there is less of a link between election results and performance in office, and closed list systems combined with presidential systems are associated with higher levels of corruption. That is not to say that these systems do not perform as well or even better along other dimensions of good governance, but the results point to the need for increased monitoring and oversight as noted above.

A particular issue that has emerged in countries in transition is how to finance political campaigns.<sup>71</sup> During the early years of transition, financing of political parties was largely ignored in the new constitutions and countries were not able to control or regulate how parties were financed, or to put in place systems to govern how this would be done on the long run. There was much discretion on the part of the legislatures and ad-hoc measures served to establish dominance of pro-government parties, create loopholes and limit transparency. Most countries in transition have tried to equalize time, via free airtime during campaigns; some require disclosure and have limits on spending or contributions. Countries in Eastern Europe have appeared to be more successful in introducing regulations to promote disclosure but they have failed to encourage diversified funding sources for political parties: funds come mainly from state subsidies (based on electoral results), corporations and large contributors. Small donations are not encouraged, via matching grants or tax credits for example, and membership subscriptions are low. There are some who think that this resulted in public

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<sup>69</sup> See “Democracy, Credibility and Clientelism” by Philip Keefer and Razvan Vlaicu, World Bank/Northwestern University, mimeo, no date.

<sup>70</sup> See “Electoral Rules as Constraints on Corruption” by Jana Kunicova and Susan Rose-Ackerman, Yale University, June 2001.

<sup>71</sup> See “Campaign Finance in Central and Eastern Europe: Lessons Learned and Challenges Ahead”, by Janis Ikstens, et al, IFES Report, International Foundation for Election Systems, no date.

dissatisfaction and lowered standards in public life, given the critical influence that financing can have on party structures, party membership, and the electorate.

As a result, many countries in transition are reexamining how to finance campaigns and political parties something that they did not do at the start. Although information is not systematic, it appears that many are moving to increase the share of public funding of parties and campaigns. In the case of Bulgaria, as of 2002, it was working towards a system of annual subsidies to the major parties making politics more party centered. It was also envisaged to be a measure to reduce corruption. However, enforcement is thought to remain weak: specific rules are needed to govern contributions against which the state audit agency can act and demand compliance with reporting norms. Reporting of contributions needs to be enhanced, including spending by parties and independent actors. The state electoral office should function as the arm of government for systematic and continuous control. In addition, more involvement of the judiciary branch may be needed to strengthen enforcement. In Poland, reforms were also undertaken. Before 2000, there were no spending limits on independent groups on behalf of parties or candidates. Now, there are limits, albeit unrealistically low, and strong penalties on parties for violations and there is considerable public funding. Control may need to be improved as enforcement has been weak: the role, funding, independence and accountability to parliament of the national electoral commission should be enhanced.

- Anti-Corruption

Controlling corruption in countries in transition has turned out to be a major challenge affecting equity and governance. Increasingly, corruption is understood not only to be the payment of bribes and the misuse of public office for private gain, but to include state capture and the unequal influence of elites in shaping laws and regulations that then benefit those elites. Examples of state capture include: private purchase of legislative votes, executive orders or judicial decisions, and illicit political party financing. According to TI's report on corruption in 1999, countries in Eastern Europe and the Baltics, showed levels of corruption at par with that in Latin America and the Middle East, while the CIS countries had the worst record of all countries.

These ratings reflect the legacy of former communist countries, under which there was a culture of state intervention and discretion. Some can be attributed to different starting points: countries in Eastern Europe may have had better trained officials and stronger institutions at the start. Some of the perceptions have been exacerbated by the mistakes made by the countries in transition to redistribute assets, especially in non-transparent privatization of state owned enterprises in Russia and the CIS countries, as well as the Czech Republic and Hungary for example.

Lasting reform to reduce corruption is deeply embedded in the emergence of strong institutions and societal insistence on high standards of performance on the part of public officials and the private sector.<sup>72</sup> Fighting corruption is a multi-dimensional,

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<sup>72</sup> See "Anti-Corruption Policies and Programs: A Framework for Evaluation", by Jeff Huther and Anwar Shad, US Treasury/World Bank, informal paper, no date.

multi-pronged, long term process, increasing restraints and deterrents, promoting public accountability and voice, enhancing the quality of the civil service, and instilling more competition in the private sector. It depends on media independence, judicial independence, and citizen participation to be successful. It requires a set of laws to limit bribery, nepotism, conflict of interest, and favoritism in public procurement and to protect whistle blowers. Separate agencies to receive and investigate complaints from the public have proven to be effective in some cases such as Chile. Broad coalitions are seen by society as the best way to lead an anti-corruption program.

So far, the results of efforts to reduce corruption in countries in transition have been mixed and corruption remains pervasive but there were many lessons and best practices that Cuba could apply. In the case of Poland, its level of corruption, as measured by TI, has increased over the late 1990s, after very good progress reported in the early 1990s: its TI index fell from 5.1 (out of 10 with 10 the lowest corruption and 1 the highest) in 1997, to 3.5 in 2004. Starting out with similar levels as Poland, Hungary too has seen its position worsened marginally (down to 4.8) and that of the Czech Republic has fallen more significantly (down to 4.2). On the other hand, Bulgaria has seen a significant improvement in its rating. Between 1999 (data for 1997 was not available) and 2004, Bulgaria's TI rating improved from 3.3 to 4.1, putting it close to South Korea, the Czech Republic, El Salvador, Slovakia, and Latvia. During that period, Estonia and Slovenia, Eastern Europe's best performers, continued to show very high ratings on corruption, both at about 6.0, comparable to the rating for Israel, Portugal, Uruguay, and Taiwan. Chile still leads the way with a TI rating of 7.4 as of 2004.

**Box 12: Bulgaria's Anti-corruption Efforts**

Bulgaria is striving for membership in the European Union. Demonstrating that it can curb pervasive corruption in the country is one of the things that it will have to do. The majority of people think that corruption is widespread, especially in tax administration and customs, as well as payments needed to move a slow bureaucracy along. Reacting to the problem, the government adopted, in 1998, an integrated National Strategy for Combating Crime containing the state's policy for fighting crime in general and corruption in particular. That plan created a system of administrative controls, modernized the legal framework, established rules and standards on administrative services, and set up a register of financial and property assets of public officials. Considerable attention has been devoted to the Ministry of Interior, that state organ for the police and internal security, traditionally an area of abuse under the previous authoritarian regime. A specialized unit in the National Service combating Organized Crime was created in 1999, specifically to handle corruption cases. The government has since adopted a National Strategy on Combating Corruption, focusing on anticorruption reform in the judiciary, increased transparency, special measures in customs and local governments, and cooperation on a wider scale of institutions. In 2004, a specific program was adopted to address corruption and the judiciary. All of these measures have been fostered by heightened awareness of corruption thanks to Coalition 2000, a non-for-profit, public-private umbrella organization, formed in 1997, to spearhead civil society's participation in this process. Coalition 2000 has acted as a watch dog on the government's commitments and the motivator for building a multi-party, multi-sector consensus on anti-corruption. The first phase of their attention was on the lack of transparency. It has since moved to issues of corruption at local levels of government and promoting civil society participation in anti-corruption initiatives. Coalition 2000 operates with extensive international and local support. While there is still a long ways to go, there are signs of improvement. One of them is the reduction in the size of the underground economy. The major complaint is that while the government has been able to address "petty" corruption, it has not faced up to major instances and systemic problems.

**Source:** Corruption Assessment Report 2004, Coalition 2000, Center for the Study of Democracy, 2005; First Round Evaluation , Evaluation Report on Bulgaria, Directorate of Legal Affairs, Council of Europe, May 2002.

Looking more closely at Bulgaria, it is clear that it has focused aggressively (see Box 12). According to a study by the European Bank for Reconstruction and Development,<sup>73</sup> Bulgaria's intensity index for its efforts between 1999 and 2002 was higher than the efforts by Hungary and Poland, rated only modestly for their efforts. On the other hand, both Poland and Hungary rate very highly on having a good legal framework for anti-corruption: this covers laws on corruption in the civil service, financial disclosure, procurement, freedom of information, party finances and anti-money laundering. But both appear to have been less active in undertaking anti-corruption measures. In particular, Poland, as of 2002, did not have a national anti-corruption strategy/action plan, anti-corruption commission or ombudsman.

- Justice

The justice system in countries in transition is at the nexus of social justice and good governance. At the start of transition, these systems were state-centric, emphasizing the anti-collective nature of crimes and dangerousness to society.<sup>74</sup> Cuba's judicial system is likely to be in a similar state. Prosecutor's offices were all powerful and penalties were harsh. There was no guarantee for the individual: legal systems were highly politicized and justice was often called "telephone" law because powerful individuals could determine the outcome by a telephone call. The ability of the judiciary to act independently, interpret fairly and impartially, resolve disputes, and provide recourse to abuse by authorities was a serious concern.<sup>75</sup> Even now, judiciaries in countries in transition are not trusted and investors rate most countries in transition as performing poorly on enforcing contracts and whether or not oversight mechanisms will be respected.<sup>76</sup> Another concern was efficiency: an international study of the time that it took to resolve two common, petty claims (eviction of a tenant and restitution of a bounced check) in 109 countries shows that countries with socialist origins were among the slowest, taking an average of 347 days to reach a decision on evicting a tenant and 326 days to resolve restitution of a bounced check. Albeit slow, this study also rated legal systems in Bulgaria, Hungary, Romania, and Poland relatively highly on access and lack of corruption and, somewhat, less highly on enforcement.<sup>77</sup>

Reforming the courts was high on the agenda for countries in transition. Countries in Eastern Europe were keen to sign on to international legal agreements, invoking these agreements as the way to move ahead. A model of judicial reform thus

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<sup>73</sup> See "Anti-corruption programmes in post-communist transition countries and changes in the business environment, 1999-2002" by Franklin Steves and Alan Rousso, Working Paper No. 85, EBRD, October 2003.

<sup>74</sup> See "Transition in the Field of Criminal Law and the Right to Defence: A View from Estonia" by Dr. Lauri Malksoo, University of Tartu, mimeo, no date.

<sup>75</sup> For background, see "Transition in the Field of Criminal Law and the Right to Defense: A View from Estonia", by Dr. Lauri Malksoo, University of Tartu, no date.

<sup>76</sup> See "Investment Climate Indicators", World Bank Investment Climate Surveys as reported in World Development Report, World Bank, 2005

<sup>77</sup> See "Legal Structure and Judicial Efficiency: The Lex Mundi Project", Simeon Djankov et al, World Bank/Harvard University/Yale University, Revised Draft, October 2001.

emerged among Eastern European countries, reflecting the guidance of the European Court of Justice and the work of the Council of Europe, the European Court and Commission of Human Rights, a distinctly European perspective but one that has also guided administrative reforms in Australia, Canada, and New Zealand. It covers the rules and regulations of the courts, the appointment and discipline of judges, budget and management processes for court administration, the functioning of the ministry of justice, and oversight by parliament, to name a few. Procedural issues also have to be resolved include: oral versus written arguments, use of professional judges versus laypersons, time limits on decisions, the rules of evidence, the nature of appeal and superior review, the nature of statutory interventions and independent procedural actions and so on.

Generally, there is considerable regulation of judicial fairness on the side of the individual to avoid abuse of power by the state and protection of judges to make them less susceptible to subversion. In addition, there is the expectation that judicial decisions will be void of discrimination based on religion, gender, or race, among other things. On the other hand, heavy regulation can lead to higher costs and delays and unwillingness to use the courts. Some of this heavy burden needs to be relieved through reform. Importantly, actors in the system have to be educated in new principles and processes, overcoming past prejudices and cultural legacy.

One of the barriers to legal reform in countries in transition has been the lack of empirical data on the system and how it works. This is partly explained by the difficulty in accessing court records and the vast amount of information, usually written and not organized, that must be reviewed. Collecting statistics has to be one of the first steps.

**Box 13: Legal Aid: A New Development in Albania**

Albania, one of the poorest countries in South Eastern Europe, has been unable to provide legal services to its citizens despite the government's efforts at reform and adoption of the principle that all defendants should be represented with legal council in court. Poor citizens do not know the law; people never bring their cases to court because they do not know their rights or cannot afford to pay for legal services. It is estimated that about 30 percent of litigants have no representation. Legal aid to the poor has emerged in response to this vacuum with the expectation that such assistance, now provided by independent non-governmental organizations, will eventually be integrated into private pro-bono and public programs and managed via public defense offices. Legal aid started in Albania in 1997 as part of a program offering support to women. By 1999, it had evolved into a separate legal aid organization, named the Tirana Legal Aid Society, serving the poor and supported by international donors and NGOs. Its target population includes the unemployed, orphans, disabled, low income pensioners, and members of large families with low incomes. These groups were identified on the basis of poverty analyses, official poverty and needs assessments. Services are limited to civil, administrative, family and labor law and mainly focus on providing legal advice and compilation of documents, along with attendance at court. Administrative law services include assistance in welfare benefits, residency, housing, civil status and child registration while family law support covers divorce, alimony, and division of property, for example. The NGO also carries out information campaigns, provides a legal hotline, and mediation services for settlement outside of the courts. Increasing, it is monitoring how well the legal system works and working with the government to design new measures to improve it.

**Source:** Legal Aid: A New Development in Albania, by Ardjana Kalo, Tirana Legal Aid Society, Albania, mimeo, no date

Albania is an example of a country that has undertaken sweeping reforms, creating new authorities for court administration (separating this function from judges),

establishing judicial inspectorates to monitor the system, and carrying out judge testing.<sup>78</sup> In addition, it was worked to expedite decisions, with the creation of an execution of judgment office in the ministry of justice and introduction of alternative dispute resolution mechanisms. To add to public availability of information, all laws and regulations are published. One of the main tenants of the reformed system was the right to a defense; however in Albania, as in many other countries in transition, affordability remains a challenge. In the meantime, legal aid for the poor is provided by a not-for-profit organization (see Box 13).

Developing countries also provide examples of reforms that can improve the quality, access and efficiency of legal services with attendant benefits for the poor.<sup>79</sup> The introduction of small claims courts in the United Kingdom, started in 1973, has expanded access to justice. These courts offer less risk of encountering high costs if the case is lost; litigants tend to prefer, or feel more comfortable, with these courts' informal proceedings; and most judges adapt well to the flexibility needed to be effective. Spain offers an example of how to set up an independent judicial council, now a common part of the European model of judicial reform adopted in most countries in transition. This council helps to overcome some of the problems in the appointment of judges, inspection and discipline measures. Many European countries, in fact, have been making radical changes in disposition of procedures such debt collection and judicial auctions by dejudicializing these disputes, relying on default judgments or otherwise making resolution more automatic.

In Latin America, Guatemala offers an example of a country that pursued legal modernization as an inherent part of its post-conflict agenda, recognizing that the lack of resolution of long standing grievances, the impunity of human rights violations, vigilante violence, and corruption may have heightened the feelings of social injustice fueled during the conflict.<sup>80</sup> Guatemala's program includes expanding the presence and coverage of the legal system to all parts of the country, community outreach, educational campaigns in schools, and introduction of mediation and alternative dispute mechanisms. Between 2002 and 2004, almost 15,000 cases were handled, with more half of them resolved by mutual agreement.

### Decommunization, Social Capital, Cohesion and Inclusion

Transition has been traumatic for the concerned societies: while both liberating and enhancing of individual civil rights, transition destroyed many of the social organizations and control mechanisms on which society, for good or for bad, relied and which provided stability. But the former systems of social control by the authorities,

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<sup>78</sup> See "Legal and Judicial Reform in Europe and Central Asia" by Poonan, Gupta et al, Working Paper Series, OED, 2002.

<sup>79</sup> See a variety of PREM best practice notes: Writing an effective anti-corruption law (no 58, October 2002); Access to justice: the English experience with small claims (no. 40, May 2000); Governing the justice system: Spain's judicial council (no 54, June 2001); and Reforming the courts: the role of empirical research (no 65, March 65), World Bank.

<sup>80</sup> See "Guatemala: The Role of Judicial Modernization in Post Conflict Reconstruction and Social Reconciliation", Social Development Notes, No. 21, World Bank, February 2005.

exercised by intimidation, were built on fear, and encouraged conformity and obedience.<sup>81</sup> For the old system to work, especially in the later years in the former USSR, societies saw the emergence of networks of fixers who acted as intermediaries to overcome supply constraints and meet production targets. These same middle-men were well positioned, especially in Russia, with the collapse of the economy to fill the void and benefit personally from the opportunities. Countries had experiences human rights violations, criminalization of social protest, and, in the worst of cases, killings.

Years of communism were debilitating for societies in countries in transitions. Studies, making comparisons with OECD countries, show that during the 1990s countries in transition have had low social capital in the early years of transition, and that the situation did not improve quickly, despite the generally high level of human capital found in Eastern Europe.<sup>82</sup> On average, countries in Eastern Europe had low trust in public institutions, parliament, police, unions, and civil servants and more trust in the church. They relied most on their families and less on friends. Notably, the military did not rank low in terms of trust. With a few exceptions, societies in countries in transition did not actively participate in social organizations, including the church.

These starting conditions were compounded by new stresses. All countries in transition experienced increases in poverty and income inequality during 1990s as measured by Gini coefficients. The deterioration was modest in the case of the Czech Republic, Hungary, Slovenia, Romania, and Poland, leaving these countries with income inequality levels that are still among the best in the world and comparable to levels in the Nordic countries. On the other hand, the deterioration has been more significant in countries such as Armenia, Georgia, Bulgaria and Russia with inequality in these countries now comparable to levels in Latin America, the highest in the world.<sup>83</sup>

While the sources of these changes vary country to country, the main reason has been the widening of disparities in wage levels, reflecting premiums for skills and education, and the emergence of a new class of self-employed entrepreneurs. These conditions have been compounded by the distributional impacts of land reallocation, privatization, and taxation which in most cases have been mixed. Women may have been more disadvantaged in this process, as compared to men. At the same time, there was a generalized increase in the level of crime and harmful activities such as prostitution, illegal drug use and human trafficking. Minorities, especially the Roma, became a target for discrimination. In the worst of cases, in the Balkans, the new freedoms of democracy allowed ethnic differences and old grievances to lead to ethnic breakup, separatism, and violence. On the other hand, countries in Eastern Europe, by and large, managed the transition peacefully. Avoiding conflict has been an important factor in explaining overall progress in transition.

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<sup>81</sup> See “Missing social capital and the transition in Eastern Europe” by Martin Paldam and Gert Svendsen, University of Aarhus-Aarhus School of Business, discussion paper, IMAD conference, Denmark, 2000.

<sup>82</sup> See “Social Capital in Transition: A First Look at the Evidence”, by Martin Raiser et al, Working Paper No. 61, European Bank for Reconstruction and Development, February 2001.

<sup>83</sup> For an analysis of inequality and explanations of how this came about in countries in transition, see “Making Transition Work for Everyone”, World Bank, 2000. Gini coefficients in the best performing countries are in the range of .30 while the worst performers have Gini coefficients of about .50.

Against this background, countries in transition had to confront three main challenges. The first was what to do with the old regime. The second was how to promote social equity and lastly how to build tolerance and inclusion within society. Only three dimensions of these challenges are discussed in this paper, namely, decommunization, new institutions to protect human rights, and emerging social problems including discrimination, crime, and HIV/AIDS.

- Decommunization

Almost all countries in transition went through some form of decommunization, that is, a break with their communist past.<sup>84</sup> The extent to which this has happened is largely dependent on the continuing strength of the former communist party in the respective country, usually related to that the origins of the transition in the first place. Countries, such as Poland, Hungary, Romania, and the Czech Republic, in which the transition was led by dissidents, have done more to make a break than countries such as Russia in which the reformed communist party played a significant role in the transition. In fact, in Poland, as of 1993, only 30 percent of the political elite were former communist party members, as compared to 83 percent in Russia. A central focus of decommunization has been how to address crimes, human rights violations and abuses by the former regimes.

There is general agreement that some form of breaking with the past is healthy: it gives voice to victims, and allows different parts of society to coalesce about new principles of openness, fairness, justice and transparency. Other countries have faced similar problems, notably South Africa at the end of apartheid, and countries in Latin America, such as Argentina, Brazil, Chile and Uruguay, at the end of military rule.

According to the guiding principles by the Council of Europe, there are five main ways to do this: prosecution for crimes, amnesty of individuals and/or groups, truth fact finding and reconciliation, reparation, and lustration.<sup>85</sup> Countries may also choose to do nothing, provide immunity, and start afresh. The experience of South Africa, Argentina and Chile of their respective truth-fact finding commissions is highly regarded as providing comprehensive and officially sanctioned conclusions.<sup>86</sup> Both Argentina and

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<sup>84</sup> For references on this section, see “Lustration” by Eric Brahm, Beyond Intractability.org, “Decommunization in Romania: A Case Study of the State Security Files Access Law, by Ioana Borza, Civic Education Project, 8<sup>th</sup> International Student Conference, Hungary, May 2000; and “Purging the Past: the Current State of Lustration Laws in the Former Communist Bloc” by Mark Ellis, Law School, Duke University, Autumn 1996.; “Does Lustration Promote Trustworthy Governance?: An Exploration of the Experience of Central and Eastern Europe” by Cynthia Horne and Margaret Levi, Truth and Honesty Project, Budapest Collegium, discussion draft, January 2003; “Truth and Reconciliation Commissions: A Review Essay and Annotated Bibliography” by Kevin Avruch and Beatriz Vejarano, The Online Journal of Peace and Conflict Resolution, Issue 4.2, Spring 2002; and “Reconciliation in Times of Transition: The Role of Parliaments and Inter-Parliamentary Bodies” by Mark Freeman, Policy Briefing Paper, 110<sup>th</sup> Assembly of the Inter-Parliamentary Union, Mexico, April 2004.

<sup>85</sup> See “Resolution 1096 (1996) on Measures to Dismantle the Heritage of Former Communist Totalitarian Systems, Parliamentary Assembly, Council of Europe, 1996

<sup>86</sup> See “Cuban National Reconciliation: Report of the Task Force on Memory, Truth and Justice”, Latin American and Caribbean Center, Florida International University, 2003.

Chile provided reparations to victims, not necessarily to reimburse victims fully for the harm done to them, but as a gesture of recognition of actual harm. Amnesty of junior officials also played a role in Chile and Argentina to provide closure but remains contentious, especially in Argentina, the criticism that the victims have been deprived of their right to justice. Immunity has been useful in a few cases to accelerate the transition, but like amnesty has problems of apparent impunity for top leadership.

Among the alternatives, countries in transition have pursued lustration in various forms. Lustration generally means the vetting or screening of individuals to ascertain if their prior participation in the communist party or its secret service should act as barrier to their future holding of positions of high authority and/or participation in the political process. The main reason why lustration has been chosen by these countries is that the nature of abuse under many former communist regimes was seen to be systemic, and not individual: many in society, if not most, were implicated in carrying out or complying with official police. Some of the actions by countries in transition to implement lustration have been highly contentious and challenged by international courts and critics. Some actions have been overturned by the countries own courts as unconstitutional. They can be seen as politically motivated and prone to error: files may have been destroyed and some have been shown to be false.

There were a few cases of the other alternatives being used in countries in transition. In unified Germany, access was provided to individuals to the files of secret police under the Gawk Commission. In addition, Germany prosecuted individual crimes such as the killings by border guards of individuals attempting to cross the Berlin wall. But this was only done if there was a specific crime and the act was illegal according to the laws prevailing at the time. There was no retroactive application of new laws.

The Czech Republic's program of lustration is considered the most extreme and the most controversial. It was one of the first, adopted in 1991, and focused on those individuals who were former party officials, members of the People's Militia, and members of the National Security Corp as well as suspected collaborators, specifically those whose named in the files of the secret police as informers. Tens of thousands of people were initially affected and barred from holding a range of positions in state-owned enterprises, academia, politics and the media first for first five year, and then another five. In 1993, the by-then Czech Republic further declared the Communist Party illegitimate and criminal. By 1994, some 210,000 persons had been screened. The international community has criticized these measures on the grounds that they discriminated in employment and violate human rights in that they assign collective guilt to individual solely on the basis of membership or affiliation; according to international court rulings, the Czech Republic has been deemed as going to far in the case of academia and the People's Militia. Such court rulings have begun to establish the tests under which lustration law would be valid.

Hungary took a different tack. It first attempted to prosecute those responsible for helping to crush the 1956 uprising. However, this required extending the statutes of limitation which was overruled by the Constitutional Court. Then, these cases were

classified as war crimes and crimes against humanity which have not statute of limitation. In 1994, the government adopted a measure to screen about 12,000 officials to determine whether or not they collaborated with the former secret police. The officials to be screened included politicians, army commanders, ambassadors, press, TV managers, chiefs of police, academics, and managers of state owned enterprises and financial institutions. This too was overturned by the courts as being too broad. The law then established that anyone born before 1972 must be screened before taking an oath before Parliament or the President. If there was evidence of collaboration the person is asked to resign, and if that does not happen, the information is made public.

Poland is one of the last countries in transition to put in place lustration measures. It attempted to do so early in the transition but no measure was enacted. By 1996, it began work on a comprehensive lustration law that came into affect in 1997. It requires that anyone/being considered for a senior public position or an elected office has to obtain a certificate of his/her status with regard to collaboration with the former communist regime. The intent was to have people ex ante disclose their relationship with the secret police: if the findings of the investigating panel confirm what was declared, then there is no obstacle. But if the person did not disclose all, he/she can be banned from public office for 10 years or sentenced for perjury. In addition, Poland has taken steps to allow public access to thirty year old files of the secret police.

- Human Rights Institutions

Not only did countries in transition attempt to secure justice for those victims of human rights abuses in the past, they moved to set up institutions to prevent violations in the future. Among Eastern European countries, the tendency has been to sign and comply with international agreements that establish the standards for their respective local legal systems. Poland signed the European Convention on Human Rights in 1992 and, as a member of Council of Europe, Polish citizens can petition the European Court of Human Rights. This court will hear cases from member jurisdictions pertaining to torture, slavery and forced labor, right to life, fair trials, privacy and family life, freedom of thought and so on. Such international venues have been welcomed in countries in transition as checks on the discretion of local authorities.

These international agreements have guided an array of local institutions. Two key ones are constitutional courts that adjudicate cases of potential violations of individual rights under new democratic constitutions. These courts go hand in hand with offices of ombudsmen. Poland is considered to have had great success in protecting human rights with an ombudsman since 1988.<sup>87</sup> Notably, Poland began the process of economic and political liberalization even before the change in regime: roundtable talks in 1989 lead to an independent judiciary, freedom of association, and numerous constitutional innovations that provided for a transition to free parliamentary elections. Poland's ombudsman was modeled after that in Scandinavia, with extensive jurisdiction to oversee protection of human rights. The ombudsman can investigate actions of

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<sup>87</sup> See "Notes: Human Rights in Transition: The Success and Failure of Polish and Russian Criminal Justice Reform" by Shannon Krasnokuishi, Case Western University, no date.

administrative bodies, including prisons, and inspect these organizations, reporting only to the parliament. He/she can act on his/her own, or on behalf of an individual. He/she can criticize authorities and state agencies. Tribunal decisions are final and binding.

A continuing concern in many countries in transition is the role of the police in enforcing human rights, especially since in many countries the police themselves had been complicit in violations under the former regimes.<sup>88</sup> As an institution, thus, the police have to be part of the reform effort: as noted in the case of Bulgaria, the role and operation of the Ministry of the Interior, in charge of the police and intelligence functions, as well as investigations and public prosecutions, has been a particular focus of anti-corruption and judicial reforms. The central theme is that the police will align themselves with the cultural and historical aspects of the country; they cannot be asked to lead social change, but it is clear that the police too must change as the transition takes hold. Professionalizing is critical: specific instructions, specialized recruitment and training. According to Amnesty International, the international watchdog on human rights, police misbehavior or inattention to civil rights, particularly with respect to the Roma minority, is a common thread in Eastern Europe.<sup>89</sup> Concerns include the illegal use of force and firearms by the police, ill treatment of accused, and torture.

Official institutions are not the only ones active in the field of protecting human rights. There are many not-for-profit organizations that serve to bring injustices to the fore and protect society against future violations. Examples include associations of former prisoners in the Czech Republic that provided mutual support and pursued violations in the courts, and Street Law, a program supported by Harvard University, to teach school children, prisoners, and civil society about the law, human rights, and democracy. The People in Need Foundation, located in the Czech Republic, supports human rights, as well as relief and development, in its own country and others, including Cuba. Based in its experience in transition, People in Need believes that it can help others in the same fashion as the way the Czech dissidents were helped. The Czech Republic has created its own program to provide support for independent organizations in other countries in transition, emerging democracies, and human rights affairs.

Hungary has also promoted the active participation of civil society in human rights matters, along with other public policies, facilitated by the creation of public foundations, a mixed venue supported by the state.<sup>90</sup> The Illyes Foundation is the leading example in support of community development. The Kemeny Zsigmond Foundation, linked to the Ministry of Education, sponsors educational projects, buys school equipment, and grants scholarships for study outside of Hungary. The Helping Hand Foundation finances medical treatment for poor Hungarians.

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<sup>88</sup> See citing of “Policing Post-Communist Societies: Police-public violence, Democratic policing, and Human Rights” by N. Uildriks and P. van Reenen, Inersentia, Holland, 2003 by the EU Monitoring and Advocacy Program, Open Society Institute, March 2004.

<sup>89</sup> See “Europe and Central Asia: Summary of Amnesty International’s Concerns in the Region”, Amnesty International, June 2004.

<sup>90</sup> See “The Hungarian Diaspora in Eastern and Central Europe” by Csilla Ban, excerpt from “Migration and Political Intervention Diasporas in Transition Countries”.

- Emerging Concerns

Unfortunately, increases in poverty and inequality, low social capital and weak institutions in many countries in transition have created the conditions under which social cohesion and inclusion deteriorated.<sup>91</sup> In this section, only a few manifestations of these problems are introduced, not to offer solutions but to heighten awareness and the need for attention during the process of transition. It may be that Cuba is already confronting some of these problems, stemming from the deterioration in living conditions faced during the special period of the 1990s.

The first issue is the status of women under transition.<sup>92</sup> The starting conditions were generally positive; that is, equality was achieved at least in official terms, women had equal access to education and employment, and there were many social programs and transfer to assist families balance work-life responsibilities. By and large, the underlying conditions of equality have not changed, but there have been changes that affect women, some times adversely.<sup>93</sup> Greater awareness was needed in the design and implementation of reforms to pension systems and cash transfer programs with particular attention paid to elderly women living alone and female headed households. One of the potential adverse affects is access to education: although not widespread, experience in Bosnia shows that female secondary students may be more inclined to drop out as compared to males.<sup>94</sup> There may also be differences in participation in tertiary education. In addition, efforts to down size the public sector may affect sectors or occupations in which women are disproportionately represented than men (i.e., the social sectors, low paying clerical jobs). In all countries except Slovenia, employment by women has fallen more than employment by men, during a time when employment fell overall. Moreover, women may not have as able as men to take advantage of new opportunities: men's employment has risen more than women's in the financial services and banking, an expanding sector. Nor than they had the same opportunities as men in self-employment: women tend to lack networks, access to credit, and information on markets and partners.

Despite years of official equality, social attitudes towards gender and female participation in the labor force may be conservative. There are reports that discrimination against women has been rising in the private sector: as compared to the former state-owned businesses, it may be easier for new private sector firms to discriminate especially

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<sup>91</sup> See "Crime, Violence and Inequitable Development" by Francois Bourguignon, EHESS and Delta, conference paper, Annual World Bank Conference on Development Economics, Washington, April 1999.

<sup>92</sup> See "Women in Transition", the Monee Project, Regional Monitoring Report, No. 6, UNICEF 1999. Also, see "Gender and Transition: The Case of Eastern Europe and the Commonwealth of Independent States", by Danuta Huber, Development Outreach, World Bank Institute, Spring, 2001. Similar conclusions were reached in various notes and publications on gender by the UNECE.

<sup>93</sup> For examples, see "Impact of Social and Economic Transition on Family Policies" by Dr. Nada Stropnik, Institute of Economic Research, European Population Forum, Geneva, 2004.

<sup>94</sup> See "Gender and Poverty: A Life Cycle Approach to the Analysis of the Differences in Gender Outcomes, by Michael Lokshin and Thomas Mroz, World Bank Policy Research Working Paper No. 3153, World Bank, October 2003.

considering that there may be little legal protection and enforcement.<sup>95</sup> A survey of social attitudes showed that, in the Czech Republic, Hungary, and Poland, a significant portion of the publics in these countries—55-67 percent—thought that it was a man’s job to earn money and a women’s job to look after the home.<sup>96</sup> The majority of respondents—50-74 percent-- also thought that a pre-school child is likely to suffer if his or her mother works. These levels are almost twice the rates in Western Europe, Australia and North America.

The second emerging issue is discrimination against minorities. In the case of Cuba, this would not be based on ethnic origins but on race. Most countries in transition have complex settings of ethnic relationships. As noted above, in extreme cases, these settings erupted into violence and breakup of countries among ethnic and religious lines. But the most common problem that has emerged is discrimination against the Roma population. Many countries have seen an outbreak of violence against the Roma and there are reports of their exclusion from social programs, eviction from housing and so on.<sup>97</sup> Previously, official policies made a concerted effort to assimilate Roma and to minimize ethnic differences. In some respects, these policies were culturally repressive and ineffective as they did not fully equip the Roma to cope with a market economy. The Roma tended still to be less educated and had language barriers. Cradle-to-grave programs tended to create a culture of dependency. So when adjustments were made in the economies in transition, the Roma were the first to be laid off and faced significant problems of reentry. During transition, as a group, they become poorer and more segregated. In reaction to these concerns, the main affected countries—Bulgaria, Croatia, the Czech Republic, Hungary, FYR Macedonia, Romania, Serbia and Montenegro, and Slovakia—have joined together to support a decade long, multi-faceted program to improve the conditions of this minority and end severe discrimination.<sup>98</sup>

The third social issue is the rise in crime in countries in transition similar to what Cuba may be experiencing. While data are not systematic, there are many reports of the increase in crime and violence in most countries in transitions. Russia is considered to have experienced an unprecedented rise in crime.<sup>99</sup> Since 1994, with loose rules for creating corporations, fraud and embezzlement under pyramid schemes became common, increasing 40 fold between 1992 and 1995. Reports indicate that this high degree of criminality in the economic sphere was brought about by the way in which Russia privatized and redistributed assets to insiders. Conditions were obviously made worse by

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<sup>95</sup> See “Gender and Transition: The Case of Eastern Europe and the Commonwealth of Independent State”, by Danula Hubner, Development Outreach, World Bank Institute, Spring, 2001. This conclusion was also repeated in “Gender Equality: A Lot More Needs to be Done”, press release, UNECE, 2004.

<sup>96</sup> See “Female Labour Force Participation: Trends and Main Determinants in OECD Countries”, by Florence Jaumotte, Economics Department Working Papers, No. 376, ECO/WKP (2003)30, Organization for Economic Co-operation and Development, December 2003.

<sup>97</sup> Ibid, Amnesty International.

<sup>98</sup> See “Roma in an Expanding Europe: Breaking the Poverty Cycle”, by Dena Ringold, et al, Conference Edition, World Bank, 2003. Also, see the press release for the International summit launching the decade of the Roma, Open Society Institute, January 2005.

<sup>99</sup> See “Crime in Russia: Understanding its Development during Transition: A Regional Approach” by Rudiger Ahrend and Yury Andrienko, The Stockhold Institute of Transition Economics, no date.

delays in approving a comprehensive criminal code (not done until after 1995). On the other hand, in the Slovak Republic reported crimes per 1,000 inhabitants actually dropped from 27.4 to 17.4 in the period 1993 to 1999.<sup>100</sup> The World Bank's Investment Climate Indicators (WDR 2005) show that crime is not considered a major constraint for business in many transition countries: among them, survey respondents in Poland and Russia indicated that greatest level of concern but even then levels are still far below those in other developing countries.

New manifestations of crime are particularly worrisome. These include violence against women and children, sexual exploitation and trafficking, and use and trafficking of illicit drugs. In particular, opportunities to migrate and greater mobility have opened new venues for sex industries and human trafficking: it is estimated that between 120,000 and 175,000 women from Eastern and Central Europe and the CIS migrate to Western Europe to supply the sex industry each year.<sup>101</sup> According to UNICEF, this trafficking goes beyond young adult women, and includes children, taking advantage of vulnerabilities, family breakdown, divorce, suicides, civil strife, poverty and high risk life styles involving drugs and alcohol.<sup>102</sup> Some 14 countries in the region now have a specific action plan, almost half had adopted legislation against child pornography, and some have advanced on enforcement. Increasingly, NGOs, such as IOM in Romania, are becoming advocates for greater protection for children.

Along with greater mobility and harmful behaviors such as intravenous drug use is the threat of an increase in HIV/AIDS.<sup>103</sup> So far, countries in transition, like Cuba, have modest-to-low levels of HIV/AIDS infections, but rapid social and political change can often spread HIV, primarily through men and women who have many sexual partners, do not use condoms, and have other sexually transmitted diseases. HIV also spreads rapidly among people who inject drugs and share unsterilized needles. The rise in prostitution and drug use in countries in transition makes the region vulnerable to epidemics of HIV and other STDs. (Countries in the Caribbean that have thriving tourism industries face a similar high threat.<sup>104</sup>) A leading indicator is thus the rise in STDs: Russia experienced an increase from 5 cases of syphilis per 100,000 in 1990 to 263 cases in 1996 is now considered one of the new wave countries.<sup>105</sup> Authorities need to be attentive to these risks by preventing infection by those with the riskiest behavior, providing information about prevention, subsidizing and popularizing the use of condoms, and generally reducing harmful behavior. Collecting information on the prevalence of infections and risky behavior is essential: this is one of the greatest

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<sup>100</sup> See "Slovak Republic Living Standards, Employment and Labor Market Study", Report No. 22351-SK, World Bank, August 9, 2001.

<sup>101</sup> See "Economic Roots of Trafficking in the UNECE Region", Fact Sheet 1, UNECE, December 2004.

<sup>102</sup> See "Taking Stock" Progress in Europe and Central Asia since the first World Congress against Commercial Sexual Exploitation of Children", Budapest Meeting, UNICEF, November 2001.

<sup>103</sup> See "Looming AIDS Epidemic in Transition Economies—Can It Be Avoided?" by Martha Ainsworth, Beyond Transition: the Newsletter about Reforming Economies, World Bank, February 1998.

<sup>104</sup> See "HIV/AIDS and Mobile Populations in the Caribbean: A Baseline Assessment", International Organization for Migration, June 2004.

<sup>105</sup> See "Population and Reproductive Health Issues in the ECE Region: the Political Scene". Bu Jorg Maas and Christina Resch, Background Paper, European Population Forum, 2004.

weaknesses in countries in transition. In addition, most countries in transition monitor those least likely to be infected, while ignoring the most likely. Regardless, governments have to be prepared to make investments in health systems to counteract these threats.

The last area of concern is out migration and brain drain. While there are few systematic statistics on this problem, several countries in the poorer parts of Eastern Europe and the CIS report declines in total population. One million Bulgarians, of whom 85 percent were under the age of 30 years, have migrated since 1989: most went to Germany, the USA and Spain.<sup>106</sup> About 1/5<sup>th</sup> of Georgia's population has migrated since transition started even though there has been repatriation by former migrants. Officials estimate that one-sixth of Bulgarians of working age still hope to migrate. In Moldova, one-third of migrants are among the country's educated teachers and nurses. The 1990s has also coincided with a net outflow of skilled professionals, scientists and information technology specialists in Russia. About 1000-2000 highly educated workers are estimated to have left mainly to Israel and Germany.<sup>107</sup> Armenia saw about 10 percent of its population leave during the 1990s and roughly 1/3 of these had college degrees. The main reason for emigration is the wide differential in average wages between most countries in transition and the receiving countries in Western Europe. One can imagine that for many Cubans the opportunity to migrate would be an attraction option.

## **PART IV: APPLYING THE LESSONS**

When faced with the opportunity of the fall of the Berlin Wall initiated in 1989, most countries in transition in Eastern Europe and the CIS were not prepared for the task ahead. There were some exceptions: both Poland and Hungary has already begun the process in the late 1980s. In other cases, such as Czechoslovakia, the political will and inherent institutional capacity were there to respond quickly. In other cases, countries were not equipped for the rapid rate and comprehensiveness of the changes that they were soon to undertake. But these countries were not alone. As demonstrated in the examples cited in this paper, there were many actors there to help. Only a few examples are cited in this paper: international bodies and agencies, international NGOs and local NGOs, the Catholic Church, unions, civil society in general and diasporas.

- International Organizations

It is striking to observe the influence that international organizations have had in establishing new standards in countries in transition. Agencies attached to the European Union were closely associated with the direction taken in Eastern Europe. Key agreements on accession including human rights, for example, have been instrumental in guiding the process of transition to the European norms and standards embedded in these agreements. These agreements were regularly monitored and assessed, providing feedback to the new governments on where they are and what they needed to do. The

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<sup>106</sup> See "Northern, Eastern Europe", Migration News, University of California, Davis, October 2004.

<sup>107</sup> See "Globalizing Talent and Human Capital: Implications for Developing Countries" by Andres Solimano, ECLA, conference paper for 4<sup>th</sup> Annual World Bank Conference on Development Economics, Revised, August 2002.

OECD has been influential in generating research, providing comparisons, undertaking surveys and promoting anti-corruption, helping countries in Eastern Europe to benchmark their performance. The EU-funded SIGMA program actively assisted countries in transition to understand and build capacity for administrative reforms, set up policy-making bodies, and improve core government functions. Similarly, the EBRD, IMF and World Bank, besides providing financing, have helped in sharing international standards, especially in areas such as fiscal management, transparency, banking regulation, central bank operations, anti-corruption, banking, investment climate, measurement of living standards, pension reforms, and so on. Equally, UN based agreements, especially on issues such as social development, HIV/AIDS, gender, and children's rights have been important to benchmark changes in these areas. Undoubtedly, bilateral assistance—notably from the UK and the USA—has also been important in defining democratic structures and providing technical assistance. Many of these agencies could play a positive role in Cuba, too, along with regional organizations such as the IDB and OAS.

- Local and International Non-governmental Organizations

Local and international NGOs were also very important in determining best practice, and perhaps even more importantly in acting as watch dogs on what these new governments were doing. Organizations such as Transparency International and Amnesty International, by benchmarking global positions, were well equipped and credible to assess conditions in countries of transition. On the other hand, the wealthier countries in transition were not priorities for international NGOs, such as Oxfam, Save the Children, and Christian Aid: these NGOs were more concerned with relief and eradicating poverty in post-conflict situations and the poorest countries in transition. On the other hand, numerous local NGOs and human rights NGOs were active in influencing policy, promoting human rights, and building coalitions. This is especially the case of programs for anti-corruption, and capacity building.

The participation of civil society in countries in transition has been critical. The collapse of the former regimes has found expression in many civil society programs and activities, including religious, business, political, and labor associations. Starting from a low base, there has been a significant expansion of civil society in line with rising incomes and increased civic awareness. Two institutions were there from the start: the Catholic Church and the labor union, Solidarity. Both were instrumental in advancing the goals of transition in Poland well before the fall of the Berlin Wall. But, while dynamic, local NGOs may be still struggling. Almost all countries in transition have passed legislation governing the activities and legal status of locally established NGOs but some of these legal frameworks are restrictive, limiting NGO activity to specific fields such as education and culture. Nevertheless, there are impressive experiences to cite of local NGOs being able to partner with the state to promote better public policies. Cuba could expect to see a similar level of commitment on the part of NGOs for capacity building and institutional development, as well as monitoring policy development and implementation.

- Benefactors

While not a common occurrence, large benefactors have played a key role in countries in transition. The most well known and largest is the Open Society Institute sponsored by George Soros, a wealthy US-based financial investor of Hungarian origin. The Open Society Institute works via a network of philanthropic organizations active in more than 50 countries—primarily Central and Eastern Europe and Russia—dedicated to building and maintaining the infrastructure and institutions for an open society. This network supports a range of programs on civil society, education, media, public health, and human rights, as well as social, legal and economic reforms. Together, the Open Society Institute and the network spend more than US\$ 400 million annually. Another example is the Lincy Foundation, created by Kirk Kerkorian, specifically to fund development programs in Armenia. Mr. Kerkorian, of Armenian origin, has committed, since 1998, US\$ 172 million (grants and loans) to support SMEs, housing, highways and streets, as well as renovation of cultural institutions. These might be only two individuals but they should the potential for mobilizing the wealth and contacts of individuals for the benefit of their former homelands.

- Diaspora

Countries in transition had high expectations for the support—both moral and financial—from the large populations of former nationals who reside outside of their home countries. The most effective support has been moral, both for former citizens who live as migrants outside of the home country and for those residing within the national boundaries. Countries in transition, such as Poland and Ukraine, confronted the situation in which many of their former nationals live in neighboring countries (as immigrants or because of shifting borders). Building solidarity among these dispersed communities has been important for historical cultural identify and nation building, aimed mainly at populations living outside of the homeland. This has been focus of various conferences (for example, the First World Conference of Compatriots of Russia (1991), the World Federation of Hungarians, the Polish Community Association (1990) and the Armenia-Diaspora Pan-American Conference (1999)). In the case of Poland, a Trans-border Congress was established to facilitate relations between the country and Polish communities abroad.<sup>108</sup>

Diasporas have been strong advocates for their homelands. This has been manifested in a flow of aid and capacity building efforts to local institutions, and lobbying their own governments for support, expanding official assistance and providing strong endorsement of the newly democratic governments. Diasporas have tended to be unconditional in terms of local politics and have largely not engaged in the day-to-day participation in economic and political life.

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<sup>108</sup> See “The Senate and the Polish Diaspora” by Longin Pastusiask, 2003

On the other hand, economic benefits to the homeland, outside of remittances, have not met expectations.<sup>109</sup> In Poland and Slovenia, the first few years of transition saw rapid rise in local SMEs, followed by inflows of traditional foreign direct investment (FDI), making the contribution by the diasporas marginal. In the case of Russia, the new head of the International Council of Russian Compatriots, expressed disappointed in the level of interest by Russians outside of the country to invest.<sup>110</sup> Instead, Russia experienced a massive outflow of capital. In Armenia, the Armenian Development Agency has specifically targeted the diasporas as one of its potential sources of investment, and has seen tangible results with most FDI comes from countries with large Armenian populations, especially Russia.<sup>111</sup> The World Bank's private sector arm, the IFC, made its first investment in Armenia in 2001 in partnership with the US-based Armenian business community. Nevertheless, even in this case, the overall level of FDI in Armenia remains low. Local politicians remain suspicious of the diaspora's intentions and many of the diasporas themselves are preoccupied with unresolved historical issues, rather than looking forward to the country's development. Thus, Cuba might be cautious and not overly optimistic in the acceptance and level of economic support forthcoming from its diaspora.

## **PART V: CONCLUDING COMMENTS**

As surveyed in this paper, transition to a market based economy and an open, democratic government is a daunting task. So far, after about fifteen years, only a few of countries in Eastern Europe are back to where they were economically in 1990. In the meantime, their people have suffered unemployment, low real wages, inflation, poverty and deterioration in social conditions. But there are clear signs that there is no going back, despite the difficulties, and the most advanced in the region have already achieved or are nearing accession to the European Union.

There may be much that Cuba could learn from these experiences as well as those of many countries in Latin American facing similar issues. A summary of key lessons is presented in Annex 1. Cuba, in facing its own transition at some point, can be informed of what these other countries have done—both positive and negative—while deciding what to do for itself. The hope is that Cuba, armed with the knowledge of what others have done, could advance on the learning curve, accelerate processes and avoid mistakes. This entails collecting information on social and other conditions, assessing distributional impacts, setting up systems to protect the poor and vulnerable, and using taxes and public transfers to make societies more equal and inclusive. It also means continuing to expand opportunity especially in terms of education and health care. It further included measures to improve the quality of public institutions, protect human rights, nurture inclusion and

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<sup>109</sup> This differs from the experience of China, in which overseas Chinese supplied 70 percent of Foreign Direct Investment over the past 15 years. By 1995, it was 59 percent of the total. See "Better Investment Climate for Everyone", World Development Report 2005, World Bank, 2004.

<sup>110</sup> See "How to Attract the Russian Diaspora", by Tatiana Kamoza, New Times, February 2005.

<sup>111</sup> See "Ten Years of Independence and Transition in Armenia", National Human Development Report Armenia 2001, UNDP.

social capital within society and prevent harmful behaviors. And, finally, these experiences show that there are many sources of support during the transition that Cuba could tap.

The experiences described in the paper are evolving and there is much more to learn. The paper, itself, provides only a sketch, limited and partial. No doubt, there are other deserving experiences missed in this paper to uncover and reflect. In many areas, in-depth research would be warranted. The distribution impacts of different ways of reallocating and restituting land and housing needs to be examined more fully. The important area of privatization could justify extensive review and discussion on its own. Administrative reform is another complex area. In some cases, the survey was been partial with incomplete solutions with the search for better ways still ongoing. Lessons are evolving in the case of education. Some areas—such as labor regulation, health care and pension reform—remain complex and controversial, not only in developing countries but in development countries. The learning process for Cuba should thus continue.

## **Key Lessons**

The paper has shown the diversity of experiences, both positive and negative, among the countries in transition. It has further shown the relevance of experiences from Latin America in addressing similar problems in Cuba. Each area covered in the paper has its own extensive technical background and literature to provide practitioners with more complete information. The intent here is not to replicate that information, nor provide a comprehensive set of best practices. Rather, this is a quick list of more general lessons on approaches and processes that might be helpful to emphasize.

### Property Distribution and Restitution

- Be prepared for a very long process—it took countries in transition ten years—so start early
- Negotiate where possible, but watch for unwarranted large settlements
- Set trigger dates as make the process feasible and practicable
- Use a mix of vouchers and actual physical transfers with a goal of enhancing equity
- Include as many as beneficiaries possible, again to encourage equity
- Involve local communities to monitor/watch for abuses and capture of process by elites along with clear rules from the center
- Anticipate continuing to manage state lands and releasing state lands for productive use
- Start early and invest heavily on the setting up of institutions to manage property (cadasters, maps, records, titles)
- Try to ease the burden on the court system with alternative dispute mechanisms
- Avoid fragmentation by encouraging transfers and associations while breaking up too large farms
- Facilitate alternatives such as leasing
- Watch for high fees and costs in property markets and avoid distress sales
- Safeguard environmental standards of land use

### Affordability of Housing, Basics Services and Foodstuffs

- Liberalize prices, including food stuffs, housing rents, and set utility prices at economically justified levels
- Where feasible, design socially progressive tariffs/prices
- Integrate subsidies for basic services, food, housing etc, into the overall social safety net, and analyze need on the basis of family household expenditure
- Build up data on these expenditures and institutional capacity to analyze poverty, vulnerable groups and social protection
- Use proxies to target beneficiaries

- Subsidize demand, not supply, especially in housing

#### Informal Sector

- Encourage and it make easy for the informal sector/SMEs to participate in the formal economy
- Avoid high non-wage labor and other taxes that discourage job creation

#### Unemployment Benefits

- Provide modest benefits at the start and refine later if needed for those in the worst situations
- Distinguish between unemployment insurance and social protection programs
- Set benefits in relation to minimum wage
- Mix cash transfers with work fare and conditional programs
- Complement unemployment support with active labor policies

#### Pension Reform

- Weed out abuses and special benefit programs
- Alter eligibility, retirement ages, etc, as needed to reflect changing demographic conditions, replacement rates
- Don't overly use early retirement and disability as a way to reduce the labor force
- If cuts are necessary, watch the impact on the most vulnerable elderly, likely to be single men and women living alone. If needed, supplement payments of these groups as part of integrated social protection program
- Cap benefits to the wealthiest and/or make benefits taxable, and begin the conversion of the program to basic payment plus voluntary participation in capitation schemes.
- Watch the level of replacement and corresponding employer/employee contribution in the mandatory plan

#### Social Safety Net

- Upgrade data collection efforts and institutions, including panel data and quick response systems
- Integrate into overall risk management system, including pensions and unemployment insurance, and subsidies for basic services
- Use conditional transfers to encourage human capital formation and use of essential health services
- Target and manage errors of exclusion and errors of inclusion, along with proxies and ways to lower administrative costs
- Expand funding for well targeted program (low errors of inclusion) that have low coverage, shifting resources from universal programs, non-means tests programs
- Move towards a "minimum guarantee income" instead of fragmented programs

- Focus on the institutional capacity of local governments to administer social protection programs following central guidelines
- Put extra effort in knowing and reaching out to the extremely poor and groups that may be discriminated against
- Plan to spend at least 2 percent of GDP on targeted social assistance during the transition

#### Education and Health

- Protect enrollment in pre-school and secondary education (non-mandatory)
- Plan for expansion of tertiary and upper/technical education with increased cost recovery if needed
- Plan for new investments in health to meet new demands for prevention including HIV/AIDS, violence against women, etc
- Institute performance based management systems with greater autonomy and community participation, while strengthening accountability and evaluation
- Build up data on system performance
- Rationalize facilities, labor force and services
- Don't squeeze out materials and supplies
- Budget on a per capita basis adjusted for risks and characteristics of those served
- Deter informal payments
- If co-payments or out-of-pocket expenses are necessary, incorporate these costs into the integrated social protection program and/or programs of waivers, targeted insurance for the poor, and/or part of conditional transfers
- Watch access/service for vulnerable groups: elderly, children, minorities, rural populations

#### Administrative Reform

- Try for a comprehensive approach but realize that this is a long term proposition
- Start administrative reform as early as possible
- Focus on building institutional capacity and legal framework for cross-cutting functions (eg civil service, financial management, budgets, policy coordination)
- In parallel, reform individual ministries and agencies to develop service delivery capacity and sectoral policies
- Fill in the institutional and data gaps—for example, competition policy, corporate governance, accounting standards, financial disclosure, poverty data, social analysis, etc.

#### Tax Policy and Administration

- Encourage participation of SMEs/informal sector
- Instill good systems for large tax payers, single payer identification, audits and computer systems that facilitate cross checking data with financial system and other areas to detect corruption and evasion

- Educate tax payers and build trust
- Anticipate decline in tax revenues because of the production shock and shifts in tax base
- Consider tax simplification and reducing tax rates while improving compliance and enforcement/auditing
- Unify or integrate systems for tax and social security (pension, health insurance)

#### Decentralization

- Watch for going too far; not a panacea
- Make fiscal transfers equitable, reflecting a clear assignment of responsibilities, and adjust them for regional differences/risky populations
- Place fiscal curbs on municipalities, especially on debt
- Encourage participatory budgets and community involvement

#### Political Institutions

- Research the different forms of democratic/constitutional structures, what works and what doesn't. Take care in adopting closed list systems
- Ensure adequate monitoring and oversight of political and electoral processes
- Start early on setting limits on party and campaign finances

#### Anti-corruption

- Tackle corruption aggressively
- Build wide coalition
- Have watch-dogs and monitors
- Collect and publicize data

#### Justice

- Pick a model at the start
- Link to international/regional agreements and standards
- Look at best practices in setting up judicial councils, training judges, alternative dispute mechanisms, budgeting/administration of courts, deregulating judicial processes etc
- Develop new laws needed for a market economy and for democracy.
- Collect data and empirical evidence
- Educate the public and the legal profession
- Support legal access by the poor

#### Decommunization

- Choose among, and use a mix of options—truth commissions, reparations, prosecution, amnesty, and lustration

- Open information to the public
- Conform to local laws, best practices and conventions in international human rights

#### Human Rights Institutions

- Incorporate constitutional courts/tribunals and ombudsmen at the start
- Link to international agreements and standards
- Professionalize the policy force and security agencies
- Have watch-dogs and monitors

#### Awareness of Emerging Issues

- Be prepared for increases in crime, gender and racial/ethnic discrimination, illegal drug use, and sexually transmitted diseases, among other things
- Adopt gender sensitivity in the design of new policies and programs
- Plan prevention programs and strengthen legal basis for enforcement of anti-discrimination laws
- Invest in health systems, facilities and public information
- Be prepared for out-migration and brain-drain of highly skilled

#### Accessing Support

- Reach out to diverse sources of support
- Tap into experiences of other countries
- Concentrate on capacity building and institutions
- Focus on adhering to internationally accepted standards, protocols and conventions
- Encourage development and involvement of civil society and independent press

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