

**CUBA**

**LESSONS OF TRANSITION**

**INCOME INEQUALITY**

**CAN CUBA AVOID THE WORST?**

PRESENTATION

BY

MYRNA ALEXANDER

GOVERNANCE AND SOCIAL JUSTICE  
CONFERENCE

MONTREAL

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# **OUTLINE**

- **IMPORTANCE OF EQUALITY**
- **GLOBAL TRENDS IN INEQUALITY**
- **EXPERIENCE OF TWO COUNTRIES—HUNGARY AND ESTONIA**
- **FACTORS THAT INFLUENCE EQUALITY**
  - **Assets—land and housing**
  - **Wages and other Income**
  - **Opportunity to Education and Health**
  - **Financing—Fiscal Policy and Taxation**
- **LESSONS FOR CUBA**

# **WHY EQUITY IS IMPORTANT**

- **PROS AND CONS FROM ECONOMIC PERSPECTIVE**
- **DIFFERENCES AMONG COUNTRIES REFLECT SOCIETAL VALUES—E.G. HUNGARY AND ESTONIA**
- **GREATER EQUALITY IS ASSOCIATED WITH GREATER ECONOMIC GROWTH BUT DEBATED**
- **GREATER EQUALITY CONTRIBUTES TO SOCIAL COHESION AND SUPPORT FOR REFORMS AND FORMATION OF SOCIAL CAPITAL**
- **GREATER EQUALITY MITIGATES AGAINST SOCIAL EXCLUSION AND CRIME**

# GLOBAL TRENDS IN INEQUALITY

- **ANALYSIS USES GINI INCOME COEFFICIENT WITH DATA LARGELY FROM WORLD BANK RESEARCH**
- **INCOME INEQUALITY INCREASING GLOBALLY**

**AMONG COUNTRIES—0.545 AS OF ABOUT 2000 AS COMPARED TO 0.485 IN THE MID-1970S**

**AMONG INDIVIDUALS IN THE WORLD—0.65 AS OF 1993-1998**

- **TRANSITION ECONOMIES: CENTRAL AND EASTERN EUROPE**

**HAD LOW INEQUALITY BUT SAW LARGE INCREASES DURING TRANSITION: GINI COEFFICIENT OF 0.273 AS OF 1987-1990 WHICH GREW TO 0.336 AS OF 2003**

**TWO PATTERNS HAVE EMERGED:**

**(1) SOME COUNTRIES STARTED FROM A LOW LEVEL OF INEQUALITY AND SAW SLOW GRADUAL RISE DURING TRANSITION--EG HUNGARY AND CZECH REPUBLIC: GINI COEFFICIENT OF 0.214 IN 1987-90 TO 0.268 IN 2003**

**(2) OTHERS EXPERIENCES A RAPID RISE IN INEQUALITY AT BEGINNING OF TRANSITION FOLLOWED BY MORE STABILITY—EG RUSSIA AND ESTONIA: GINI COEFFICIENT OF 0.240 IN 1987-90 TO 0.402 IN 2003. NOTABLY GINI FOR CONSUMPTION IS LOWER THAN FOR INCOME—EG. RUSSIA HAD GINI COEFFICIENT OF CONSUMPTION OF 0.330 IN 2003\***

\*Consumption is considered a better measure of overall wellbeing.

## • CHINA AND VIETNAM

**LIKE OTHER COUNTRIES IN TRANSITION, BOTH STARTED WITH LOW INCOME INEQUALITY BUT AS TIME WENT BY VIETNAM AND CHINA ARE NOW MORE LIKE RUSSIA OR WORSE**

- **CHINA: GINI INCOME COEFFICIENT OF 0.289 IN 1987-90, 0.395 IN 2001 AND 0.450 IN 2005**
- **VIETNAM: GINI INCOME COEFFICIENT OF 0.38 IN 1993, 0.37 IN 2002 AND 0.53 IN 2005**

**THIS RISE IN INEQUALITY MOST LIKELY REFLECTS GROWING GAPS BETWEEN RURAL AND URBAN POPULATIONS**

## • CUBA

**CUBA HAS ALREADY SEEN A RAPID RISE IN INCOME INEQUALITY AND IS NOT THAT FAR OFF THE EXPERIENCE OF RUSSIA, CHINA AND VIETNAM**

**GINI INCOME COEFFICIENTS:**

- **0.25-27 in 1987-1990**
- **0.38 in 1996-98**
- **0.40 in 1999\***

**IS MORE INEQUALITY INEVITABLE?**

**IS CUBA HEADING TOWARDS THE REST OF LATIN AMERICA?  
LATIN AMERICA: GINI COEFFICIENT > 0.50**

**CAN CUBA GO BACK TO LEVELS OF THE BEST OF THE EU--  
SCANDANAVIAN COUNTRIES? BEST OF EU COUNTRIES:  
GINI COEFFICIENT <0.30**

**CAN CUBA STABILIZE WHERE IT IS? ROUGHLY SAME AS  
THE USA, APPROX. 0.40**

\* This figure is consistent with the analysis on income distribution for Havana only, presented by Lia Ane, Investigator, Center of Population Studies and Development, Cuba. As noted during that discussion, the estimate of 0.40 does not include any foreign exchange revenues and thus is considered a low estimate of the actual Gini income coefficient.

# **INFLUENCING EQUALITY: EXPERIENCE OF ESTONIA AND HUNGARY**

- **BOTH COUNTRIES HAVE AGING POPULATIONS AND A HIGH PENSION BURDEN LIKE CUBA, BOTH HAVE LARGE URBAN POPULATIONS AND RELATIVELY SMALL AGRICULTURE SECTORS LIKE CUBA, BOTH HAVE WELL REGARDED EDUCATIONAL SYSTEMS AND HIGH SOCIAL INDICATORS, LIKE CUBA**
- **UNLIKE CUBA, HUNGARY AND ESTONIA ARE CONSIDERED RAPID AND ADVANCED REFORMERS, ADOPTING MARKET ECONOMIES AND DEMOCRATIC GOVERNANCE. IN FACT, HUNGARY HAS HAD MORE MARKET ORIENTED POLICIES SINCE THE 1960s. BOTH HUNGARY AND ESTONIA HAVE OPEN ECONOMIES WITH STRONG EXPORT ORIENTATIONS. BOTH ARE AT THE HIGHER END OF THE PER CAPITA INCOMES AMONG COUNTRIES IN TRANSITION**
- **BUT THE TWO HAVE HAD DIFFERENT APPROACHES TO TRANSITION AND HAVE ACHIEVED DIFFERENT LEVELS OF INCOME EQUALITY. THIS STUDY FOCUSES ON EXAMINING THOSE DIFFERENCES**

## **ASSETS—LAND AND HOUSING**

- **THE SINGLE LARGEST ASSET THAT PEOPLE ARE LIKELY TO OWN IS HOUSING AND LAND. IN THE TRANSITION TO A MARKET BASED ECONOMY, COUNTRIES IN TRANSITION DISTRIBUTED BOTH LAND AND HOUSING TO THE PUBLIC**
- **BUT EQUITY WAS NOT NECESSARILY THE PRIMARY GOAL OF THIS PROCESS. PRIORITY WAS GIVEN TO THE RESTITUTION OF ASSETS TO FORMER OWNERS WITH LESSER PRIORITY PLACED ON (I) DISTRIBUTIONAL IMPACTS FAVORING PARTICIPANTS OF COOPERATIVES; (II) ECONOMIC EFFICIENCY—E.G. KEEPING COLLECTIVE FARMS; AND (III) HONORING THE ACQUIRED RIGHTS OF OCCUPANTS**
- **THE PRIORITY ON RESTITUTION WAS MORE SO THE CASE IN ESTONIA THAN IN HUNGARY WHICH USED MORE MIXED MECHANISMS AND WAS MORE FLEXIBLE—HUNGARY REFERED TO ITS PROGRAM AS COMPENSATION, NOT RESTITUTION**
- **BUT NEITHER COUNTRY THOUGHT ABOUT DISTRIBUTION EXPLICITLY**

**→ END RESULT: MISSED OPPORTUNITIES TO AFFECT FUTURE INCOME DISTRIBUTION**

- **HIGH OWNERSHIP OF PRIVATE HOUSING**
- **PROBLEMS OF MAINTENANCE AND AFFORDABILITY**
- **NEW NEED OF SOCIAL HOUSING FOR NEW ENTRANTS**
- **HIGHLY CONCENTRATED AND DUAL STRUCTURE OF LAND HOLDINGS**
- **RENTAL AND LEASING NEEDED TO MAKE SMALL FARMS EFFICIENT**
- **LIBERALIZATION OF CONSTRUCTION AND RENTAL MARKETS HELPED**

# **WAGES AND EMPLOYMENT**

- **WAGES ARE SINGLE LARGEST SOURCE OF INCOME**
- **BOTH COUNTRIES LIBERALIZED WAGES AND GAVE EMPLOYERS GREATER FREEDOM TO HIRE AND FIRE WORKERS**
- **IMPORTANTLY, BOTH HUNGARY AND ESTONIA HAVE RELATIVELY FLEXIBLE LABOR POLICIES AND EMPLOYMENT PROTECTION**

**→ END RESULT: MUCH HIGHER AND SUSTAINED UNEMPLOYMENT AND CONSIDERABLY GREATER INEQUALITY IN WAGES EMERGED DURING TRANSITION**

- **UNEMPLOYMENT SURGED, REACHING OVER 10 PERCENT OF THE LABOR FORCE BUT JOB DESTRUCTION AND CREATION RATES WERE STILL IN LINE WITH OECD EXPERIENCE**
- **THE LONG-TERM UNEMPLOYED (>12 MONTHS) EMERGED AS A PARTICULAR PROBLEM**
- **AS EXPECTED, WAGE DISPERSAL INCREASED TO REFLECT RETURNS TO EDUCATION AND PRODUCTIVITY. WAGES INCREASED MAINLY AT THE UPPER TAIL**
- **WAGES ALSO SHRANK AS SHARE OF TOTAL INCOME WITH GAINS MADE IN LESS EQUITABLE RETURNS TO CAPITAL**
- **ALTHOUGH WAGES AT THE BOTTOM END DID NOT KEEP UP WITH INFLATION (AND IN SOME CASES DECLINED IN REAL TERMS), THE WORST HIT WERE THE UNEMPLOYED**

**→ TO ADDRESS UNEMPLOYMENT AND POVERTY, BOTH COUNTRIES COMPENSATED WITH**

## **UNEMPLOYMENT INSURANCE AND ASSISTANCE BUT EMPLOYMENT CONDITIONS WERE WORSE IN ESTONIA THAN IN HUNGARY**

- **IN THE CASE OF HUNGARY, MORE WORKERS DROPPED OUT OF LABOR FORCE AND DREW ON MORE GENEROUS PENSIONS AND HIGHER SOCIAL BENEFITS. ALTHOUGH ESTONIA'S SYSTEM WAS HIGHLY PROGRESSIVE, ESTONIA KEPT UNEMPLOYMENT ASSISTANCE TO A MINIMUM AND ONLY COVERED A SMALL SHARE OF THE UNEMPLOYED**
- **HUNGARY RETAINED A LARGER PUBLIC SECTOR AND EXPERIENCED HIGHER GAP BETWEEN PUBLIC AND PRIVATE SECTOR WAGES, PERHAPS DAMPENING WAGE PRESSURES IN THE PRIVATE SECTOR**
- **HUNGARY ALSO EXPERIENCED HIGHER PARTICIPATION OF UNIONS IN LABOR FORCE AND GREATER COORDINATION OF COLLECTIVE BARGAINING ONCE TRADE UNIONS ADAPTED TO NEW ECONOMIC RULES**
- **HUNGARY HAD A SMALLER INFORMAL, UNREGULATED SECTOR WITH MORE WORKERS PROTECTED BY LABOR LEGISLATION**
- **IMPORTANTLY, BOTH COUNTRIES ADJUSTED THEIR APPROACH OVER TIME: HUNGARY REDUCED ITS UNEMPLOYMENT BENEFITS AND INCREASED EMPHASIS ON ACTIVE LABOR POLICIES, WHILE ESTONIA INCREASED ITS UNEMPLOYMENT SUPPORT. STILL ESTONIA, COMPARED TO OTHER EU COUNTRIES, SPENDS CONSIDERABLY LESS ON UNEMPLOYMENT SUPPORT**
- **NEITHER USED ACTIVE LABOR MARKET POLICIES TO THEIR FULLEST POTENTIAL**

# **SOCIAL PROTECTION**

- **NOT ONLY DID MORE PEOPLE FACE UNEMPLOYMENT AND LOWER WAGES, THEY FACED RISING COST OF LIVING AS PRICES OF UTILITIES AND FOOD STUFFS WERE LIBERALIZED**

**→ IN RESPONSE BOTH HUNGARY AND ESTONIA EXPANDED AND DEEPENED THEIR SOCIAL SAFETY NETS**

- **INITIALLY, THIS WAS DONE WITHOUT DATA ON INCOMES AND ACCOMPANYING POVERTY ANALYSIS AND THE FOCUS WAS ON CONTINUATION OF FAMILY ALLOWANCES AND CONSUMER SUBSIDIES THAT HAD EXISTED BEFORE TRANSITION. THESE TENDED NOT TO BE MEANS-TESTED AND THEY WERE ESPECIALLY HIGH IN HUNGARY (ABOUT 6.7 % OF GDP) AS IT HAD EMBARKED ON PRICE LIBERALIZATION WELL BEFORE ESTONIA. PUBLIC UTILITY PRICES CONTINUED TO BE HEAVILY SUBSIDIZED. THIS REMAINS AN ISSUE.**
- **BOTH COUNTRIES CONTINUED TO RELY ON THEIR PAY-AS-YOU-GO PUBLIC PENSION SYSTEMS TO PROTECT THE ELDERLY. IN BOTH CASES, PENSIONS WERE ALREADY COSTLY IN TERMS OF PUBLIC FINANCES BECAUSE OF DEMOGRAPHIC CHANGES, HIGH REPLACEMENT RATES AND LOW RETIREMENT AGES. IN HUNGARY, PAYMENTS WERE ESPECIALLY GENEROUS FOR EARLY RETIREMENT AND DISABILITY. BOTH COUNTRIES EVENTUALLY REFORMED THEIR PENSION SYSTEMS MAKING THEM MORE SUSTAINABLE AND EQUITABLE ACROSS-GENERATIONS. IN NEITHER CASE WERE THE ELDERLY A PARTICULARLY VULNERABLE GROUP WITH THE EXCEPTION OF VERY ELDERLY WOMEN LIVING ALONE**
- **WHILE BOTH COUNTRIES LIBERALIZED PRICES, INFLATION HAD DIFFERING IMPACTS. HUNGARY MANAGED TO AVOID AN EPISODE OF VERY HIGH INFLATION AND HIGH INFLATION MAY BE ONE OF THE MAIN FACTORS EXPLAINING ESTONIA'S VERY RAPID RISE IN INEQUALITY IN 1992 WHEN INFLATION REACHED 1000 PERCENT**

- **OVERTIME, THESE SOCIAL PROTECTION SYSTEMS HAVE BECOME MORE TARGETED (MEANS-TESTED) AND EFFECTIVE IN REACHING THE POOR. HOWEVER AS OF THE MID-1990s, BOTH COUNTRIES STILL HAD VERY LOW COVERAGE OF THE POOR (EXCLUDING PENSIONS) WITH ESTONIA BEING SLIGHTLY BETTER AT TARGETING THAN HUNGARY. THE SHARE OF NON-MEANS-TESTED BENEFITS REMAINS HIGH—ABOUT 96-98 PERCENT AS OF 2003—DRIVEN BY PUBLIC PENSIONS. ONLY A SMALL PERCENTAGE OF THE POPULATION—1.2-2.5 PERCENT—RECEIVE MINIMUM GUARANTEED INCOMES**
- **BOTH COUNTRIES WERE ABLE TO MAINTAIN OR SLIGHTLY LOWER THEIR SOCIAL PROTECTION SPENDING OVER TIME. BOTH COUNTRIES CONTINUE TO SPEND CONSIDERABLY ON SOCIAL PROTECTION (INCLUDING PENSIONS, HEALTH AND UNEMPLOYMENT ASSISTANCE). HUNGARY SPENDS MORE—21 PERCENT OF GDP IN 2003—AS COMPARED TO 13.2 PERCENT OF GDP BY ESTONIA. (IN COMPARISON, HUNGARY SPENT ABOUT 22 PERCENT OF GDP ON SOCIAL TRANSFERS IN 1989.)**

# **EQUALITY OF OPPORTUNITY\***

- **INCREASING RETURNS TO EDUCATION IS THE SINGLE LARGEST REASON FOR INCREASED WAGE DISPERSAL DURING TRANSITION**
- **AMONG OECD COUNTRIES. HUNGARY HAS THE HIGHEST RETURNS TO ADVANCED VOCATIONAL AND UNIVERSITY EDUCATION, WITH ONE OF THE LOWEST RETURNS TO BELOW UPPER SECONDARY**
- **SCARCITY OF HIGHLY QUALIFIED MANPOWER BECAME AN ISSUE IN THE REGION**
- **LIKE MANY COUNTRIES IN TRANSITION BOTH SAW A DECREASE IN SECONDARY ENROLLMENT DURING WORST PART OF TRANSITION (LITTLE CHANGE TO PRIMARY ENROLLMENT)**

**→ AS A RESULT, BOTH HUNGARY AND ESTONIA EMPHASIZED EDUCATION**

- **BOTH LARGELY KEPT UP ON SPENDING AS A SHARE OF GDP (BUT EXPERIENCED A DECLINE IN REAL TERMS)**

- This section only looks at education and not health. Both countries continued to offer universal health coverage. The main issues in the health sector were the emergence of informal health payments, low salaries paid to public health workers and insufficient public budgets.

- **GIRLS RESPONDED FASTER THAN BOYS**
  - **DURING LATER STAGES OF TRANSITION, THERE WAS A MAJOR MOVE TO INCREASE ENROLMENT IN HIGHER EDUCATION**
  - **IN HUNGARY, GROSS TERTIARY ENROLLMENT JUMPED FROM 37 PERCENT IN 2000 TO 65 PERCENT IN 2005**
  - **IN ESTONIA, TERTIARY ENROLLMENT GREW FASTER: FROM 38 PERCENT IN 1995 TO 56 PERCENT IN 2000 AND 66 PERCENT IN 2005**
  - **STILL A LONG WAY TO GO: THE NUMBER OF SCIENCE GRADUATES IN HUNGARY IS WELL BELOW THE OECD AVERAGE**
- **NOTE: CUBA HAS ALREADY RESPONDED**
    - **TERTIARY ENROLLMENT HAS ALREADY INCREASED TO 61 PERCENT IN 2005, UP FROM 21 PERCENT IN 1991 AND 27 PERCENT IN 2002**
    - **CUBA OUT PERFORMS OTHERS IN THE REGION ON AVERAGE**

## **FISCAL POLICIES AND TAXATION**

- **THE BIG ISSUE IS HOW TO PAY FOR SOCIAL PROGRAMS WHILE REVENUES FELL AND SOCIAL PRESSURES INCREASED**
- **NOT ONLY IS THE TAX BURDEN IMPORTANT, TAXES ALSO AFFECT NET DISPOSAL INCOME AND INCENTIVES TO WORK AND INVEST**

**→ AS A RESULT, DURING TRANSITION THERE WAS A BIG FISCAL AND TAX ADJUSTMENT: ESTONIA MANAGED ITS FISCAL SITUATION MORE STRICTLY THAN HUNGARY**

**- HUNGARY'S FISCAL GAP REACHED 8.5 PERCENT OF GDP IN 1992-93; ON THE OTHER HAND, ESTONIA'S WAS ONLY 0.5 PERCENT IN THE SAME PERIOD**

**- BY 2000-01, HUNGARY STILL HAD A DEFICIT OF ABOUT 3.9 PERCENT OF GDP WHILE ESTONIA'S WAS ONLY 0.1 PERCENT**

- **OVER TIME, THE SHARE OF THE PUBLIC SECTOR FELL IN BOTH COUNTRIES**
  - **FROM HIGHS OF OVER 40 PERCENT AT THE START OF TRANSITION, THE TAX TAKE IN HUNGARY HAS FALLEN TO 38 PERCENT OF GDP AS COMPARED TO 34 PERCENT IN ESTONIA AS OF 2002**

- **THE TWO COUNTRIES TAX DIFFERENTLY**
  - **BOTH TAX LABOR HEAVILY WITH HIGH LEVIES ON THE EMPLOYER BUT THESE CHARGES ARE HIGHER IN HUNGARY THAN ESTONIA: COMPLUSORY SOCIAL CONTRIBUTIONS IN HUNGARY ARE 46 PERCENT OF WAGES WHILE ESTONIA'S ARE 34 PERCENT**
  - **BASIC VAT RATES DIFFER—25 PERCENT IN HUNGARY AND 18 PERCENT IN ESTONIA**
  - **ESTONIA INTRODUCED IN 1994 A FLAT INCOME-PROFIT TAX OF 26 PERCENT FOR BOTH PERSONAL AND CORPORATE INCOMES, WITH FEW DEDUCTIONS**
  - **HUNGARY'S INCOME TAX SYSTEM IS MORE CONVENTIONAL WITH RATES RANGING FROM 20 TO 40 PERCENT. HUNGARY HAD A PERSONAL INCOME TAX SYSTEM IN PLACE BEFORE 1989**
  - **BOTH COUNTRIES ARE AIMING AT LOWERING TAX RATES OVER TIME**
- **UNFORTUNATELY, THERE IS LITTLE DISTRIBUTIONAL ANALYSIS AVAILABLE BUT ESTONIA'S TAX SYSTEM WOULD SEEM TO BE MORE REGRESSIVE THAN HUNGARY'S. NOR IS THERE MUCH ANALYSIS ON THE IMPACT ON INCENTIVES TO WORK/INVEST AND/OR REPORT INCOME**

## **LESSONS FOR CUBA**

- **THE FIRST LESSON IS THAT CUBA CAN HAVE A CHOICE: IT CAN ADOPT POLICIES AND PROGRAMS THAT ENHANCE EQUALITY EVEN WITH MARKET REFORMS**
- **SOCIETY CAN INFLUENCE THAT CHOICE: IN THE CASE OF HUNGARY, MANY MORE PEOPLE SUPPORT GOVERNMENT ACTION TO PROMOTE EQUALITY THAN IN ESTONIA**
- **BUT SOCIETY MUST BE WILLING PAY: HAVING THE TAX REVENUE TO SUPPORT SOCIAL PROGRAMS IS CRITICAL**
- **AND THERE ARE TRADE-OFFS BETWEEN JOB CREATION, EFFICIENCY AND INCENTIVES WITH SOCIAL PROGRAMS THAT CAN LEAD TO POVERTY AND UNEMPLOYMENT TRAPS**
- **HUNGARY AND ESTONIA DEMONSTRATE THE COMPLEXITY OF THIS PROCESS AND THE INTERACTION OF MANY VARIABLES THAT INFLUENCE INCOME EQUALITY. HUNGARY MAY HAVE BEEN TOO GENEROUS ON A NUMBER OF FRONTS WHILE ESTONIA MAY HAVE NOT BEEN GENEROUS ENOUGH**

- **CUBA HAS OPTIONS. IN PARTICULAR, IT CAN:**
  - **EXPLICITLY CONSIDER LAND AND HOUSING FROM A PERSPECTIVE OF DISTRIBUTION**
  - **PREPARE ITSELF TO ADDRESS HIGH UNEMPLOYMENT AND GREATER WAGE DISPERSAL WITH UNEMPLOYMENT ASSISTANCE**
  - **FOLLOW FISCAL AND OTHER MACRO-ECONOMIC POLICIES THAT AVOID HIGH INFLATION**
  - **ADOPT FLEXIBLE LABOR MARKET AND EMPLOYMENT PROTECTION POLICIES TO ENCOURAGE JOBS**
  - **SUPPORT THE STRENGTHENING OF UNIONS IN THE COORDINATION OF THE COLLECTIVE BARGAINING**
  - **DISCOURAGE THE INFORMAL SECTOR**
  - **UTILIZE COST-EFFECTIVE ACTIVE LABOR MARKET PROGRAMS SUCH AS TRAINING**
  - **CONTINUE THE INCREASE THE SUPPLY OF MORE HIGHLY SKILLED AND MORE EDUCATED WORKERS**
  - **COMPENSATE VULNERABLE GROUPS WITH SOCIAL SAFETY NETS**
  - **REFORM EVEN FURTHER THE PUBLIC PENSION SYSTEM, MAKING IT MORE PROGRESSIVE**
  - **REENFORCE THE CAPACITY TO MEASURE AND ANALYSIS INCOMES AND POVERTY**
  - **USE TAX POLICY AS WELL AS SOCIAL TRANSFERS TO MITIGATE INCOME INEQUALITY**