



**Cuba Transition
Project**

**WHAT CAN COUNTRIES EMBARKING
ON POST-SOCIALIST
TRANSFORMATION LEARN FROM
THE EXPERIENCES SO FAR?**

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Executive Summary

The paper starts with three warning observations:

1. All arguments that purport to make clear, confident, and specific proposals based on Eastern European, post-Soviet, Chinese, or Vietnamese experience should be viewed with reservations. There is no universal prescription.

2. Specialists involved in the post-socialist transition often protest that too little heed is paid to expert considerations when decisions are taken and that everything is being “overly politicized.” There is little point in wringing one’s hands. The change of system is above all a political process.

3. When sizing up the factual aspects of events, one can aim for positive, value-free observations and descriptions. However, when making proposals for practical regulations, one unavoidably encounters ethical implications as well.

The paper goes on to draw attention to experiences so far in the following five aspects of the change of system:

a. In fortunate cases, the spread of political democracy and conversion of the economy into a market economy based on private ownership proceed hand in hand, reinforcing each other. Nevertheless, situations sometimes arise in which trade-off relations exist between the application of democratic procedures and the requirements of effective economic reform processes. The author points out that in his view the requirements of democracy would take priority in such a dilemma.

b. The creation of the institutions and organizations of a state of law call for circumspection and precision, which, in turn, require a lot of time. It would only discredit the concept of a state of law if new, hastily drafted laws had to be repeatedly amended or faulty reorganizations constantly reorganized over and over again.

c. In respect to private property, the prime consideration is not what should happen to the state-owned property, but something much more comprehensive. What can be done to bring about the healthiest

and strongest development of the country's private sector possible? Above all, the barriers that the communist regime erected to free entry and enterprise should be dismantled and wider opportunities created for small and medium-sized firms.

Attached to the question of devising a strategy to assist growth of the private sector is a tough dilemma: To what extent should the country be opened to foreign capital? For some, the act of warding off foreigners has intrinsic value in and of itself. The author is less interested in what passports investors hold than in their specific intentions. Where there are mutual advantages to foreign direct investment (FDI), the author would encourage it or even assist it with the instruments available to the government.

What should happen to the firms that were state owned (or perhaps collectively owned) under the socialist system? If they are technically obsolete, worn out, and run down, it is usually wiser to close them. If they are heavily indebted, it is worth considering bankruptcy proceedings. The author points out the negative experiences created by the free distribution of property rights, such as the "voucher" and "coupon" programs. Selling off state-owned property at a fair price seems to be the most practicable alternative from economic and ethical points of view.

d. While there is wide agreement concerning the direction of price reform, the speed of the adjustment is highly debated. Rational economic arguments suggest there should be rapid and consistent liberalization, but this problem likewise becomes thoroughly politicized. The interests of some producer and/or consumer groups may be prejudiced. The speed desired for adjustment depends on what is more important to decision makers: improving economic efficiency with a rational system of relative prices or a calm political atmosphere with no cause for outbreaks of dissatisfaction.

e. The communist regime creates a specific kind of welfare system, which the author calls a "premature welfare state." It decides how much is spent on education, health, and care of children and the elderly in a paternalistic way, at the expense of individual sovereignty. Such paternalism becomes customary, and most of the public

adapts to it. The welfare functions of the socialist state are probably the ones that will leave the most positive collective memories after the change of system. If economic reformers put violent hands on the paternalist facets of the socialist regime, they will increase the nostalgia felt for the old order. Reforms of welfare-state activity need to be handled with caution, if only out of political expediency and a desire to promote political stability in the new system as well as sympathy for it.

Introduction

Table 1 in my book, *The Socialist System*, lists 26 countries where the “socialist system” was operating at the end of the 1980s.¹ The first two columns of the table at the end of this paper (also named Table 1) repeat the relevant data from the earlier table, listing the same 26 then-communist countries. Columns 3 and 4 show an important difference, however. Three formerly unitary countries (Czechoslovakia, the Soviet Union, and Yugoslavia) have since been divided into a number of successor states.

Several other essential changes have also taken place in the communist world. When I was writing the above-mentioned book, I used a *political* criterion to decide whether a country had a communist system. The term is applicable to a country for as long and only for as long as a monopoly of political power is retained there by a communist party professing a Marxist-Leninist ideology. That was the case with the political structure of all 26 countries at that time. See Column 7 of Table 1. The term “communist” can be applied at this time to only five countries: China, Vietnam, Laos, North Korea, and Cuba.

With the exception of North Korea and Cuba, all other countries that formerly belonged to the communist system have undergone radical transformations in their *economies*. While economic changes have occurred in many dimensions, let us confine ourselves for a moment to one: the reallocation of property rights. Column 8 of Table 1 shows that the economy of the *whole* former communist region, with the exception of North Korea and Cuba, has moved much closer to that of market economies dominated by private ownership.² This change has occurred very strongly in China and Vietnam, even though both are run by communist parties. It is doubtful whether the communist parties of these two countries have remained real Marxist-Leninist parties at all, for they have hardly retained their old ideology except in their rhetoric. Looking at China’s and Vietnam’s parties’ actions, we can see that they are in communist guise but actually friendly toward capitalism and actively engaged in implanting it.³ Whereas the political regimes in China and Vietnam remain dictatorial, the actual behavior of the political authorities seems likely to move toward pro-capitalism. So it is also correct to say that both countries have shifted away from socialism toward a post-socialist transition.⁴

A transformation of world historical importance has occurred in a decade and a half in the former communist world, which contained one-third of the world's population. Are there lessons and experiences to be drawn from that transformation for other countries? My reply is a decided "yes." This study advances some ideas to support that affirmative answer.

My arguments are not based on theoretical speculation, for I have gained first-hand experience in my own country, Hungary. Hungary's history is especially noteworthy because it began to reform its socialist economy very early, back in 1968. In addition, I have gathered extensive information about the transformation in the other Eastern European countries, the successor states of the Soviet Union, China, and Vietnam. This research is based upon primary as well as secondary sources. I have visited the various countries of the region many times and spoken with many experts on the subject. Several of them have been former pupils of mine, willing to disclose their problems openly and honestly. Furthermore, there is a rich literature available. My observations in this paper are confined to the experiences of countries where I have such knowledge. For brevity's sake, I do not repeatedly say that the empirical background of my remarks consists of some post-socialist countries, not all of them. As I know little about countries undergoing post-socialist transition in Asia, Africa, and Latin America, I will not attempt to make use of their experiences.

Those who suggested I write this study asked me to think over the lessons applicable to Cuba. While I have largely tried to do that, the conclusions I reach are more general. My arguments make clear that of the myriad relevant experiences, I am most concerned with the ones worth consideration by all countries, whether they are on the brink of a radical system change or have crossed that threshold already. In other words, the experiences described herein are worth thinking about not only in regard to Cuba and North Korea, but perhaps also in Iraq or in other countries that will one day be freed from a strict dictatorship combined with some socialist features, such as centralization and/or a large state-owned sector.

Starting Points

Here I would like to discuss three warning observations as a starting point for further analysis. In the first instance, I will express these ideas on an abstract plane, before adding some illustrations.

No Universal Prescription

Although the experiences of several countries over a decade and a half are available, they do not add up to a universal prescription for a general strategy for the post-socialist transformation or for specific tasks and tactical measures. On the contrary, pondering the experiences I have known and studied, I would warn those thinking of radical transformation in Cuba or another country to view with suspicion and reservations all arguments that purport to make clear, confident, specific proposals based on Eastern European, post-Soviet, Chinese, or Vietnamese experiences.

I would recommend being doubly suspicious of studies that support a confident proposal based on any ostensibly scientific apparatus. For instance, people have done regression analysis based on a sample of data gathered from 10 to 20 countries over a period of from 10 to 12 years. These research projects have served as the basis for statements such as, "The faster the reform, the faster the growth." An initial glance at the statistics seemed to support this conclusion "backed up by econometric means," until one day serious macroeconomic difficulties appeared, and growth slowed precisely in the countries that had been reforming the fastest.

It should be acknowledged that too little time elapsed and too small a sample was taken to draw statistically convincing, well-founded, clear conclusions from the experiences about the specific, practical tasks ahead. Furthermore, the sample was too heterogeneous in many other features falling outside the phenomenon studied. Consider how the many countries undergoing post-socialist transformation have included such a small one as Albania and such a giant as China. Among them is a country as poor as Mongolia and one as rich as the Czech Republic. Some are industrially very advanced, and some, at least at the beginning of the transition, were countries where agriculture has very great weight in the economy. In one country, most of the population is Catholic, while in a second it is Protestant, in a third Orthodox, and in a fourth Moslem. With such varied initial conditions, countries would clearly take different courses in their transition to a market economy.

There is no universal prescription. There are no specific, practical recommendations equally valid for every country. This sharp warning is in itself an important lesson. But having drawn it, would it not be better

to finish this study without further ado? I continue because I am convinced there are many useful lessons of other kinds, but the *nature* of the conclusions that can rightly be drawn has to be clarified first.

Careful study of the transformation processes that have occurred so far reveals what kinds of phenomena and relations play an important part in them. What are the problems that have to be addressed in good time, problems that cannot simply be passed by in the hope that they will somehow resolve themselves in due course? The approach I would recommend supplies a *checklist* of the problems calling for notable, serious study and action. Of course, history can always come up with the unexpected. Cuba, for instance, may face difficulties not encountered by any transforming country so far. Nonetheless, it is useful to prepare intellectually (and perhaps actively) for the foreseeable problems at least.

There is no telling from experience so far exactly when some measure will have to be taken during the transformation process or what measure it will be. But if it is not possible to give a clear recommendation, it is at least possible to tell, from studying experience so far with the post-socialist transition, something about what consequences some measure or other may have. What will be the direct and indirect political, economic, social, and cultural gains and losses by each major step? There is no chance of compiling easily quantifiable trade-off equations from previous experience with transformation, but it will be possible to say, qualitatively at least, which are *the trade-off relations most worth noting*. If this contribution of mine helps to promote a cost-benefit approach of that kind, it will have done a useful service, for there is a danger that politicians directing the future transformation of these countries may be so confident of their prophetic abilities that they see the policy they advocate as the one redeeming solution to satisfy all.

The history of post-socialist transformation so far has included quite a few spectacular failures—alterations whose political, economic, and social consequences were gravely detrimental. The price paid certainly exceeded the value of the benefits. So it is worth considering carefully what mistakes should be avoided without fail.

No Such Thing as a “Non-Political” Decision

Specialists involved in the post-socialist transition often protest that too little heed is paid to *expert considerations* when decisions are taken.

Economists object that efficiency criteria are relegated, doctors that health factors are ignored, theatre managers and museum curators that cultural considerations are not respected, and so on. And they all complain that everything is being “overly politicized.”

There is little point in wringing one’s hands. The change of system is, above all, a political process, so that *politicization* of every decision is inescapable. Capitalism is an attractive and resilient system. Even if the state and the political sphere were to stand aside (which is hard to imagine even on a theoretical plane), capitalism would still spread, gaining footholds wherever it had not been allowed to operate before. It would be enough just to lift the bans—in itself a political act. In real life, the spontaneous expansion and intensification of capitalism is strongly influenced by decisions of the state. State regulation can hamper or hasten the naturalization of the market economy based on private ownership. At best, it will set out to promote the healthy features of the development, while curbing or excluding the harmful or even criminal side-effects. In the worst cases, it will allow healthy development and its outgrowths, while ignoring or tolerating abuses.

The political sphere could not resign its responsibilities for the quality of the transformation even if some leaders neglected their duties. Not that most would want to, of course. Politicians are driven simultaneously by their political philosophy and world outlook, the interests of the groups or strata they represent, and their own interests in wielding power (and in some cases financial interests as well). They cannot look indifferently on any projected measure or action by the state. They try to intervene and influence the course events take, regardless of whether they are in office or among the opposition.

This has to be accepted as a reality from the outset. Whatever change is being made, the experts putting forward a proposal have to consider carefully its political implications. Where can they expect to find support and resistance? I myself have sometimes failed to carry out this vital piece of analysis. I hoped my recommendations would be acceptable to everyone. They never were. Reactions were sharply divided, and in some cases, a proposal of mine drew no support from any major political force.

Ethical Implications

So “expert” considerations are not enough in themselves; there are always political implications to reckon with as well. But that is not enough either. It is necessary to delve a layer deeper to analyze the experiences of the post-socialist transformation thoroughly and decide what has been to the good and what to the bad in the course of events so far. “Good” and “bad” are ethical judgments. When sizing up the factual aspects of events, it was possible to aim at positive, value-free observations and descriptions. Reliable statistics on the proportion of private ownership constitute value-free information. But to add that the present distribution of property rights was reached too slowly or too hastily is to exercise a value judgment.

Analysts seeking to go beyond merely registering events in the past or simply listing feasible alternatives and their consequences in the future have an obligation to show their colors. Let them state what system of values they use to judge that a past event or process was good or bad and what system of values they use when supporting or opposing some future measure. Or, if they are determined to avoid taking positions based on a system of values, let them at least meet the minimum requirements of intellectual honesty by carefully presenting the ethical implications. Discover and explain comprehensibly how, if this has been done in the past or this is to be done in the future, it meets ethical postulate A but fails to meet ethical postulate B. Alternatively, if not this, but something else has been done in the past or is to be done in the future, it fails to meet ethical postulate A but meets ethical postulate B.

Without attempting to be comprehensive, here are a few of the ethical dilemmas that have to be faced during the post-socialist transition:

1. Should bloodshed and *violence* accompanying the change of system be avoided at all costs? Is the nonviolent nature of the transition to be a basic postulate, or is violence permissible? If the latter is the case, what measure of bloodshed can be contemplated? How many victims? Thousands? Hundreds of thousands? This raises one of the basic issues of human history: the dreadful dilemma of reform or revolution; peaceful transformation or rebellion, uprising, and civil war. This question cannot be avoided by those considering the issues of post-socialist transition. The 1956 Hungarian Revolution was a bloody uprising that was crushed with tanks.

More than 30 years later, Hungary changed peacefully from a socialist system to a capitalist system. Not a single person was killed. Nobody had to be locked up in jail for opposing the change.

Romania was the one Eastern European country that placed its communist dictator, Nicolae Ceausescu, and his wife, Elena, before a summary court, condemned them to death, and executed them in December 1989.

Those now considering how a change of system should be carried out in a place where it has not yet occurred have to take sides in this grave ethical dilemma.

Many who put forward proposals on a future post-socialist transformation have actually tried to evade the problem, for instance, by assuming that the measures they propose will only come up after the basic change has occurred *in some form*. They devise in advance, for example, a plan for reforming public administration. Yet the social context for the future will differ if people are being lynched from the lampposts, summary courts condemning people to death, foreign occupation forces patrolling the streets, or, in contrast, if the political change takes place nonviolently. If the reformers envision a nonviolent scenario, let them say so, because this condition is not self-evident.

2. Although it ties in with the previous dilemma, there is the separate question of *justice* to decide (Barahona de Brito et al. 2001; Horne and Levi 2002; Huyse 1995). The system to be replaced committed crimes. Does blame attach only to the “system” or also to specific people who are still alive? Who can be deemed guilty and to what degree? Anyone who imagines that under totalitarianism, a pack of gangsters imposes a reign of terror and everyone else is innocent knows little about such systems. How wide or narrow a sphere should be declared criminal and punished accordingly? Should the guilty be allowed to go free or at least be condemned morally?

Who should reach the verdicts? For the more complete the totalitarian nature of the dictatorship has been, the more illusory the independence and impartiality of the judiciary will be, especially initially.

It should not be imagined that the problem can be left to a few lawyers or political philosophers concerned with the ethics of dispensing justice. To continue the earlier example, as people begin to think of reforming the administration of state, the changes required are presum-

ably not just organizational. Some people must be dismissed and replaced. This process of selection and replacement, one of the main factors in the change of system, will coincide in time and interpenetrate the process of dispensing (or sabotaging) justice. Or, replacement may interweave with justice openly, if legislation is passed prescribing in a transparent fashion which individuals are to be restricted in the public role they may take because of their activities under the old regime. With or without legislation, there will be a lack of transparency, unfair actions, and corruption. Some people will be dismissed from their jobs without due process or passed by for appointments because they were compromised under the old regime. Inevitably, others will be pushed forward by former comrades precisely because they belonged to the *nomenklatura*.

The demand for justice is one of the basic ethical postulates of mankind. What can be said against it? Worth mentioning above all is the difficulty of dispensing justice. For with the exception of a few martyrs, no one is entirely blameless. Mihály Babits, a great Hungarian poet, wrote in one of his verses at the time of the Nazi dictatorship: "Among criminals, the silent are accomplices." The sin of keeping silent was committed by many people who did not dare to speak out.

Dispensing justice is hard, because no impartial, independent, competent judiciary or judicial apparatus will have arisen as the post-socialist transition begins. Do we want to have revolutionary courts with powers over life and death? Is it tolerable for the morally charged issue of justice to become a vulgar device of political parties in their fight against one another (Gonzales and Enriques 2001)?

Another consideration is that once the avalanche of justice has begun, there is a general atmosphere of fear. Everyone is afraid of being held responsible. Those with even a little to hide are afraid, but so are the entirely innocent, for fearing of being accused or even convicted without cause. Even a suspicion is enough, because some of the shame of being accused sticks, even if innocence is later proved.

Once the wheels of justice have begun to turn, it is hard to ensure continuity in administration and business. Many of the specialists needed are soon removed or may simply resign, and there are not always people who can do the job properly to replace them. In all walks of life, a difficult trade-off between justice and continuity arises. The more radical and

rapid the former, the more frequently the latter is broken.

3. Mention was made of the *speed* of transition under the previous point, but it is worth discussing separately. It is understandable that people should be impatient after decades of dictatorship and penury and want to live under the new system immediately. Speed has intrinsic value in their eyes.

But speed has its price. Haste and superficiality of thinking will mean that the draft measures are laden with mistakes. No essential change can be implemented in isolation. The favorable effects of an essential change will appear only in company with other changes. Haste can mean that the necessary complexity of a reform is lost, and the accompanying changes and auxiliary regulations are not planned and prepared adequately. Sometimes a reform taken too fast may go into reverse. It may become clear only after a reform is made that postponement would have been better than forcing the pace.

There is no convincing theory, model or even rule of thumb for calculating an optimum speed of transition. For my part, I consider the studies on the subject to be pseudo-scientific bluff. It is like setting out to establish the optimum speed for urban traffic. In fact, drivers have to decide before each corner at what speed to approach it, depending on the road, the traffic conditions, and what the traffic taking the corner and the pedestrians are likely to do.

But the unique and complicated nature of the decision is not the only reason why there is no optimum speed. Another is the *choice of values* behind it. Different decisions will be taken by drivers who give priority to speed or to punctuality or to avoiding accidents. All three types were found during the post-socialist transition. Some politicians were speed-crazy. Some already wanted to tell the world press and the Washington financial institutions in 1995 or 1996 that their country had finished privatization first. Others wanted to proceed cautiously (or ultra-cautiously).

4. Now let us look at some *dynamic* considerations more closely. One of the central problems in economics is the dilemma of “present versus future.” The usual example given to students is the dynamics of consumer flows when the concepts of discounting and present value are explained. Is it better to consume more today, or save and invest more for the sake of more future consumption?

The problem of discounting appears when a change of system is being planned. Those alive at the time of the change of system look back on a difficult past. Most of them have suffered oppression, poverty, and shortages of goods and services. They hope they can now live better at last. Should the required institutional and structural changes be arranged so that they cause as little inconvenience and financial burden to the public as possible? Should priority go to maintaining or, if possible, maximizing living standards, so that all of the people feel they are real winners due to the change of system? This would certainly smooth the transition and help to avoid disruptions.

Or, is it more important to create firm institutional foundations for the new infrastructure and hire reliable, efficient staff members? Does this have to mean further sacrifices by the present generation on behalf of the future? Should people today suffer all the disorganization of a rapid transformation of the institutional system and the losses consequent on a fall in production? All these things have to be done with a firm hand, to eliminate the slightest risk of a reversal and to create a market economy that operates well *in the long term*.

Sharp dilemmas consisting of mutually exclusive choices have been presented here. Of course, there are intermediate strategies as well. The trade-off between present and future becomes complicated indeed if the choice variables are extended beyond the customary macroeconomic variables (production, consumption, savings, investment) to *institutional* variables as well. What I have sought to emphasize here is the idea that those taking a position on these questions have to realize that their decisions are ultimately ethical choices. They are also deciding how the population will divide between winners and losers and on the distribution of joy and suffering between present and future generations.

Some Lessons

In this section, I would like to draw attention to experiences so far in five aspects of the change of system. Even with the most impartially presented arguments, it is usually possible to tell what system of values an author espouses. I would like to spare my readers the task of discovering that by making it plain for each point the value premises on which my line of argument rests.

Representative Democracy

Communist dictatorship may be followed by several kinds of political regime:

- A repressive, strongly anticommunist regime (a military dictatorship or authoritarian rule by an extreme nationalist-conservative party or group, for instance). That was the case when the repressive regime of General Augusto Pinochet followed that of Prime Minister Salvador Allende, which had been taking Chile along the socialist road.
- Autocratic rule, in which the dictatorial features are covered by a fig leaf consisting of some aspects of parliamentarism (elections, a powerless legislature). Such regimes can be said to have arisen in some Soviet successor states in Central Asia, in some cases with continuity with the previous communist regime, members of whose political elite managed to jettison their Marxist-Leninist ideology and gain power in conjunction with business circles.
- A semi-autocratic, semi-parliamentary system. A typical example was the regime of Boris Yeltsin in Russia, in the years following the disintegration of the Soviet Union.
- An expressly parliamentary system, with real competition among parties for the right to govern.

The above order is not a random one. The list progresses from extreme dictatorship through intermediate grades to full institutional democracy. There are no sharp dividing lines, in fact. However, there is an acid test distinguishing the last category, a full multi-party system, from the rest. The democratic rules can be said to apply if a governing party or politician that loses a general election duly withdraws, handing over power without demur to victorious opponents. Once this has occurred not once but twice, the test is a robust one. Hungary and Poland have both passed it.

In fortunate cases, the spread of political democracy and conversion of the economy into a market economy based on private ownership proceed hand in hand, reinforcing each other. But that is not always the case. Democracy involves painstaking and easily protracted processes. Groups concerned have to be heard before each regulation is introduced. A parliamentary majority has to be convinced about the plans for reform. Resistance is often stronger from within the ruling party than from the

opposition. There have been cases in Eastern Europe where a government of a social democratic complexion has introduced radical privatization rules, for instance, or reforms to make the labor market more flexible, thereby curtailing the rights of workers, which meant, of course, overcoming strong opposition from within a governing party.

How much easier a “reforming dictatorship” is in that respect! If the leading group of the Chinese Communist Party decides on a market-oriented measure, it takes it, and that is that. There is no need to bother with convincing people, taking it through parliamentary committees or enlisting support from a free press and television that might turn the public against it. This makes an especially big difference if the reform calls for short-term financial sacrifices from some sections of society. If inflation has to be curbed, for instance, that involves righting the country’s macro-economic balance and eliminating the budget deficit. The tougher the political authorities can be, the simpler it is to force such painful measures through.

It cannot be verified that there is any universal, long-term conflict between introducing democracy and executing reforms designed to produce a balanced, stabilized market economy, but there is no asserting the opposite either (Barro 1996 1999; Tavares and Wacziarg 2001). Situations have sometimes arisen in which such a conflict has appeared, so that trade-off relations subsist between the application of democratic procedures and the requirements of effective reform processes. Where that is the case, priorities have to be established.

For myself, I can say that the requirements of democracy would take priority in such a dilemma. I disagree with those who argue that “the conditions for democracy will ripen later” and “the important thing now is to push on with economic reform.” That point of view has become especially widespread among business people and economic experts in poorer, economically less developed transition countries. I disagree, but if they say it directly, at least it becomes clear that two *systems of values* are opposed: one in which priority goes to human rights, freedoms, and democracy and one in which preference is given to financial prosperity and economic growth.

Confrontations of systems of values are part of a pluralist society. It is irritating, however, if double standards are applied. This can be found

among the Western advisers and observers dealing with less developed transition countries: “Of course, democracy is essential for *us*, as Westerners,” they say, “but it is less important for *them*” (referring to the Chinese, Asians, or inhabitants of poorer countries). How do they know? While the repression lasts, there is no way of telling. Furthermore, those who have never had democracy cannot know what it tastes like. The appetite comes as you eat. People begin to feel that democracy is essential once it has become consolidated and institutionalized.

Citizens in places where the post-socialist transition has yet to begin should be ready for this dilemma to arise. Their leaders should help the people prepare themselves mentally for daily encounters with this fundamental choice and its ramifications, as the preparation and introduction of each reform proposal comes onto the agenda.

Creating a State of Law

This is a vast, comprehensive task. Rather than defining it, let me point to a few important, characteristic constituents of it. There have to be basic human rights and acceptance of a multiparty system, based on political competition, and a constitution embodying parliamentary institutions. Creating a state of law entails enacting modern, constitutional civil and penal codes to enforce private contracts. It calls for a range of special laws that regulate business activity in a market-compatible way, along with the provinces, rights, and obligations of various state authorities. Parallel with the legislative activity, an independent judiciary has to be established. There have to be guarantees that the police and law enforcement systems do not abuse their powers. Everyone must be held accountable, and no one—a party or authority or the state itself—can be above the law (Sajó 1998 and 2002).

Simply listing these requirements is a warning that legal reform and the creation of the institutions and organizations of a state of law call for circumspection and precision, which in turn require quite a lot of time. It would only discredit the concept of a state of law if new, hastily drafted laws had to be repeatedly amended or if faulty reorganizations constantly had to be reorganized.

Every sphere of the transformation—the political process, the business world, or the arts and sciences—requires an adequate legal or legislative background. Lack of it will only lead to trouble and conflicts, a

lesson learned from bitter experience in places where much has already happened on the way to a transition to a market economy.

That is the lesson—I cannot and would not wish to draw a more specific or tangible conclusion. Western advisers in the early years of the Eastern European transition frequently mentioned the “sequencing” problem and urged researchers to try to devise theories and models of “optimal sequencing.” I do not think the problem is theoretically soluble. There are times when it is possible and even expedient to forge ahead a little with some measure, in the knowledge that the requisite legal environment would arrive somewhat later. But forging ahead like that can also become dangerous or even counterproductive, if it is too premature or if the requisite legislative and judicial branches are too late in catching up. It is hard to adjust the pace of different processes to each other. This paper simply seeks to issue a warning that reformers should think about this aspect. Whatever nonlegal field they are working in, they should not forget to clarify the legislative and judicial branches of government and take account of their complexity when pacing the changes.

Strengthening the Private Sector

Even in countries where power relations have altered completely in favor of the market economy, there remain some staunch anticapitalists. If they have not been convinced by the worldwide historic turn of events that buried the socialist system, this short contribution will certainly not cause them to question or change their ideas. So I am not addressing them, but those who are enthusiastically or less than enthusiastically expecting socialism to turn into some type of capitalism. These people agree in expecting that the proportion of state and collective ownership has to decrease sharply so that private ownership can become the dominant ownership form. So far, there is agreement, but this expectation leaves open a number of questions.

Political and professional debate and press attention in Eastern Europe and the Soviet successor states concentrated mainly on what would happen to firms and other assets that had been in state or perhaps collective ownership. Should they be returned to their former owners? Should they be sold to whomever was willing to buy them? Should they be given to some group of the public designated as entitled to receive them, such as employees of state-owned enterprises or tenants of state-

owned housing? Or should the entirety of the ownership rights be distributed evenly among all citizens?

Before I comment on these questions, let me make a preliminary remark. The prime consideration, in my view, is not what happens to the state-owned property, but something much more comprehensive. What can be done to bring about as healthy and strong a development of the country's private sector as possible? I will put forward my position on that first, and only then turn to analyzing privatization.⁵

Healthy development of the private sector calls, above all, for the dismantling of the barriers to *free entry* that the communist regime erected. Those wanting to do business have to meet some minimum conditions, of course—fire regulations, work safety, registration for tax purposes, and so on—but apart from that, freedom of enterprise needs to be ensured as far as possible. The communist system managed to eliminate or confine within very narrow bounds small and medium-sized firms. Private initiative has to be made possible by lifting the barriers to free enterprise. That in itself will initiate the appearance of masses of small and medium-sized firms. The development will accelerate further if the entrepreneurs receive tax breaks, preferential loans, or other supports. The small and medium-sized business sector has grown very quickly in the transformation countries.

Attached to the question of devising a strategy to assist growth of the private sector is a tough problem. To what extent should the country be opened to *foreign capital*? Again this poses a problem with political implications, indeed, one in which values ultimately clash. Is it a supreme postulate to protect national sovereignty, ward off foreign influences, and protect the producers in firms owned by national citizens? If so, the appearance of each multinational and other foreign-owned firm or the acquisition by any foreigner of agricultural land or other property is a national affront. According to this view, the act of warding off foreigners has in itself intrinsic value. Opposed to this is the view that economic growth and mounting prosperity are more important. Countries recently released from the restraints of the socialist planned economy are short of capital and have great need of investment. From that point of view, the appearance of foreign capital should be welcomed. Foreign direct investment (FDI), of course, is not made out of charity. Investors expect prof-

its, and when the time comes, some of those profits will be reinvested in the host country, and some will be repatriated. But this is not a zero-sum game, in which the investors win and the host country loses. Both sides may win. The host country finds that FDI generates employment, brings tax earnings into the state's coffers, spreads foreign expertise, and implants the working practices and discipline of industrially more developed countries (Lizal and Svejnar 2002).

For my part, I would be less interested in what passports investors hold than in their specific intentions. What investment are they planning, and what advantages and costs will it bring to the host country? Where there are mutual advantages to the FDI, I would encourage it or even assist it with the instruments available to the government. This position reflects my system of values, and it is conditional. It depends on the specific investment's intention and to what extent it promises to be favorable and deserving of encouragement and support.

Even if the government of a post-socialist country decides in favor of encouraging and supporting the inflow of foreign capital, the intensity of the flow should still not be thought to depend exclusively on current economic conditions. Whether foreign investors can count on protection of their property, whether they can enforce fulfillment of the contracts they conclude, and whether they can turn with confidence to the courts and the police for assistance if their rights are infringed—all will also depend on how firm the state of law is. Of course, the public's political mood must be taken into account as well. There is no use in the finance minister or a mayor encouraging foreign business people to invest against a background of xenophobic comments in the press or even in parliament. Political and economic phenomena are closely connected here.

Experience in the post-socialist region suggests that *new* business plays the main role in spreading private ownership (Konings, Lehmann, and Schaffer 1996; and Konings 1997). New, "greenfield" investment is what dominates the growing private sector, whether it is new small and medium-sized firms and big domestic and foreign-owned investment schemes. It is revealing that most foreign investors prefer not to bother with updating an old factory inherited from socialism and find starting a brand new one simpler and more economic.

Privatization

The previous discussion leads to the still unanswered question of what should happen to the firms that were state owned or perhaps collectively owned under the socialist system.⁶

Again, I do not think any simple, universally applicable answer can be given. There are several factors worth weighing.

The first factor is the condition of the firm at the time the problem arises. If it is technically obsolete, with broken, worn out equipment, it is usually wiser to close it. If it is heavily indebted, it is worth considering bankruptcy proceedings, from which the creditors will gain a sizeable proportion of the ownership rights. The company will be wound up as an organization and a legal entity, but its material assets can be sold. This is customarily referred to as privatization via bankruptcy.

Another factor that strongly affects the decision is the *macroeconomic position* of the country. If unemployment is rife, there is much more reason, at least for a time, to keep a factory going, even if it will never be viable in the long term. This may mean putting off or slowing down a privatization where the new owner would immediately dismiss much of the workforce. That frequent side effect of privatization is borne more easily by society if the economy is expanding, so that new firms can hire laborers released by the old firms.

The decision calls for special attention, sincere human consideration, and circumspection in countries where much of the population lives in poverty. (Cuba certainly belongs to that category.) There has to be caution about closing down inefficient firms and restructuring them in ways that involve reducing the workforce. Such action should be carried out, if possible, at times when the economic growth to accommodate the laid-off workers can be expected in the foreseeable future and after a safety net of social provisions has been installed to ease transitional difficulties. However, these social considerations must not be a pretext for putting off moves to wind up inefficient production indefinitely. For long deferment will only hold back production growth—the one truly effective, permanent way of eliminating poverty.

Privatization serves first of all to enhance economic efficiency. But that has *political* and *ethical* implications that may come into conflict with the efficiency criteria.

Mention was made earlier of justice, of trying crimes perpetrated under the old regime and punishing those who committed them. One side of justice is the question of compensating those who suffered under the earlier system. Should they receive the property taken from them by the communist authorities, that is, should there be restitution? Some post-socialist countries did so, while others did so in part. (For instance, peasants, under certain conditions, were given back their land and house-owners their houses.) Restitution runs up against practical difficulties, however, if the original assets have been altered or modernized or had investment put into them under the socialist regime, so that in their present material condition they *differ* from the assets confiscated. In those cases, there remains the possibility of financial *indemnity*, of the state paying financial *compensation* for the loss caused by the confiscation.

This presents a serious set of complex problems based on value judgments. Justice dictates that those harmed by the old regime should be compensated by the new. But who should pay the compensation? The state? Certainly, but the state has no money of its own. It spends the money of the taxpayers of today. Why should today's citizens, some of them poor, pay out of their slim earnings the price of grave injustices committed several decades ago? So there are strong ethical arguments against compensation as well. I incline to the second ethical stance, but I would like to leave the question open, simply indicating these aspects of the problem.

Do those working in a firm have a special claim on its ownership? Should the firms hitherto in state ownership not be transferred to employee ownership instead? These questions introduce socialistic ideas into the new "capitalist environment." The idea is quite muddled even within a socialist-oriented line of argument. The change of political system has occurred, and now it is time for ownership reform. At this point, state-owned firm A is doing well and making good profits, while firm B is suffering serious losses. The high profits at A are not the employees' doing. They are lucky to have inherited up-to-date equipment and a product range that suits the new market conditions. The losses at B have not come about through the employees' negligence. The technical equipment is poor, and there is no demand for the products under the new market conditions. Ownership of firm A, therefore, constitutes a gift from the nation

to the firm's employees, while the employees at B will be taking over serious burdens from the state, if they agree to accept them at all.⁷ What is the justification for rewarding the employees of firm A and penalizing those of firm B in this way? It contradicts the most elementary requirements of justice.

Plans were drawn up in several post-socialist countries to distribute ownership rights equally among all citizens. The proposal was heard first in Poland and applied first in the Czech Republic as *voucher privatization*. Every citizen could apply for a certificate (voucher) granting ownership over specified state assets. The same form of privatization was later applied widely in Russia. The rules of the Czech and the Russian schemes were not identical, but they matched in basic economic, social, and ethical respects. Some other post-socialist countries applied the same scheme, but less comprehensively than the Czech Republic or Russia.

The undoubted advantage of the voucher approach is that it produces very rapid privatization. The property simply has to be taken from the state and divided among the citizens, who may buy shares with their vouchers, deposit them in investment funds, or sell them. The voucher system was opposed by advocates of another strategy: selling off state-owned firms at a fair price, using special auction procedures, to those offering the best terms for them.

Several kinds of arguments were advanced (Kornai 2000a; World Bank 2002). Voucher-scheme advocates pointed mainly to political considerations (Boycko, Shleifer, and Vishny 1993, 1994, 1996; Shleifer and Treisman 2000). State ownership had to be ended as soon as possible, thereby taking from the old economic elite their most powerful weapon and preventing any restoration of the old order. This is a strong argument, so long as the danger of communist restoration is a possibility. Discussing whether the argument really stood up in the Eastern Europe of the mid-1990s or the Soviet successor states might be interesting but is peripheral to this study, as it is concerned with the strategies of future post-socialist countries. If privatization takes place in a political environment that presents a danger of communist restoration, then a cogent argument exists for eliminating state ownership rapidly, which should take priority over other requirements. However, if the domestic power relations and factors beyond the country's borders are strong enough to withstand any attempt at

restoration of a communist regime, then this argument no longer applies.

I have already mentioned a mania for speed. Some people press for state ownership to be dismantled urgently, regardless of whether there is a danger of restoration. They want to give priority to the requirement of establishing the bases of a capitalist market economy *as soon as possible*, with privatization as the most important factor. Since this concerns a choice of values, one set of values can be countered only by another. Critics of this line of argument, including me, have emphasized that speed is not the most important objective; far more important objectives are the solidity and operative efficiency of the new system. The mechanism for choosing owners efficiently was discovered a very long time ago, and that is the market for property rights. The property of the state has to be sold at a fair price. Those who buy it will be prepared to pay because they reckon they can operate it economically and will do all they can to ensure that they succeed (Murrell and Wang 1993; Poznanski 1993; Zinnes, Clifford, and Sachs 2001).⁸

Other ethical arguments have also arisen in these debates. The earlier ideological defense lawyers for state ownership would stress that the factory belonged to the people as a whole. Therefore, if it belongs to all of the people, every citizen is entitled to part of the state property when it is privatized. This egalitarian argument seems bizarre to me when a capitalist system is being created. If a state-owned firm is sold at a fair price and the proceeds are returned to the state's capital account, there has not actually been any change in the wealth of the state, simply a change of form. Let us assume that the privatization proceeds are used to reduce the state's foreign debt or for productive investment, such as development of the infrastructure. In that case, the wealth of the state, far from being reduced, will hopefully continue in a more efficient form. Nothing has been "taken from the people." In fact, the more effective utilization of the wealth of the state is to their benefit.⁹

A precondition for success in reallocating property rights is creation of a workable state of law. The privatization process must be preceded by a minimum level of institutional reform. This observation is supported by many positive and negative experiences.

Transparency

Several mentions have been made of a *fair price*, if the strategy of selling off state property is chosen. To put it more precisely, the assets have to be sold under a proper contract on fair terms.¹⁰

Here, unfortunately, I have to report negative experiences. Cases of negligence, fraudulent accounting, and wasteful expenditures by organizations charged with effecting the sales of state assets seem to have been frequent, and the process usually became tinged with corruption. These situations then deteriorated because discovery and prosecution of the corruption and negligence were rare, while each country resounded with rumors of abuses that could not be confirmed. Perhaps some of the rumors were unfounded, and the problems were exaggerated. Certainly, a great deal of mud, justified or unjustified, stuck to these historically important change of ownership processes.

Everyone is uncertain at this point. Does mud-slinging inevitably accompany such a huge transfer of wealth? Or can countries undertaking ownership reform keep the process clean or at least contain the corruption at a lower level?

The defensive techniques are well known. What is needed is a body of legal regulation, formulated prior to privatization, expressed clearly, with no loopholes for those intent on enriching themselves (while keeping within the letter of the law), by making off with state assets under the nose of the treasury. The procedures have to be as transparent as possible. If one state agency is to be responsible for the sales, there should be another, independent agency to monitor them as closely as possible. Let the monitoring agency have access to every detail and ways of vetoing transactions before it is too late. Parliament and the press must have access to the monitoring process as well.

Price Reform and Liberalization

One basic requirement for a smooth-running market economy is for prices to play their part in controlling supply and demand. Among the biggest problems with the socialist planned economies were the gravely distorted relative prices of transactions.

Almost all economists agree on the direction in which the price system has to go. The need is for relative prices that reflect relative scarcity to produce equilibrium on the market. Additional debates on whether

adjustments should be done in one stage or several and at what speed have taken place (EBRD 2000, 2001).

Efficiency considerations alone suggest that a radical reform is most expedient. All prices have to be freed from controls and the market allowed to set equilibrium prices. One natural concomitant of radical price liberation is import liberalization. A free flow of foreign goods into the country will force down high prices caused by low levels of domestic production. And if the country has been dependent on imports of a particular product and hitherto kept the price of it artificially low, liberalization of prices and imports will open the way for a rise in the product's relative price. This will prompt users to be more frugal with the product.

Rational economic arguments suggest there should be rapid and consistent liberalization, and within their own logic, these factors cannot be denied. Yet, so far, there has not been one case of rapid and consistent liberalization. Social forces resist this idealized view, so the situation becomes thoroughly politicized. And ideas and values can be cited in protest against it, thus value choices are involved as well.

If the prices of the most essential goods and services that feature large in the budgets of lower-income households rise, these people and their political representatives will protest, which may, in turn, dissuade the government from making the requisite price adjustments. The prices of various energy sources, for instance, were kept artificially low for such reasons in several Eastern European countries, and in some remain so.

The interests of some producer groups understandably may be biased. In Hungary, for instance, an economically justified rise in petrol prices elicited protests by taxi drivers that escalated into a blockade of the Danube bridges, splitting the capital in two and paralyzing it, forcing the government to retreat. Competition from imports and prices deemed too low brought repeated protests from agricultural producers.

There is no clear rule for calculating an optimum speed for price reform. It depends on what is more important to decision makers: improving economic efficiency with a rational system of relative prices or maintaining a peaceable society with no cause for dissatisfaction that might translate into antigovernment votes at the next general election. The decision about the speed and sequencing of liberalization of prices and imports has to be taken in relation to the prevailing political and eco-

conomic conditions. My preliminary impression from the information available is that it would not be wise to set a rapid pace, because the social and political prices of doing so would be too great. But let me repeat that is only a preliminary impression, not a decisive, clear-cut recommendation. A responsible position on this could only be taken after a thorough and up-to-date appraisal of a particular situation.

The clash here is between ultimate values, not just political forces. How much will we listen to our minds, which prescribe an adjustment of prices, and how much to our hearts, which lead us to empathize with those whose meager real incomes will shrink further as a result of the reform? These same people were the main economic victims of the old regime, and now their penury is to be prolonged by the grave upheavals of the transition period.

Reform of the Welfare State

One prominent feature of the socialist system is comprehensive redistribution. Citizens receive medical care, education, and pensions by right, and a network of state-financed institutions (such as kindergarten and after-school centers) provide child care.

Most of the socialist countries in which welfare states develop are poor and backward. The quality of the services mentioned is usually low: poor medical care, low pensions, and so on. Nevertheless, the law prescribes equal access. I christened this formation a “premature welfare state” in an earlier work of mine.

The effects of a premature welfare state are inconsistent because the power of central decision-makers is increased, and the sovereignty of individuals is decreased. The state centralizes much of the income, while those in charge of its plans decide how much is spent on education, health, and the care of children and the elderly. Central planning is not confined to the aggregate targets; it goes down to tiny details as well. Decisions about the services mentioned are taken not by individuals or families but paternalistically, by the state. Such paternalism becomes customary, and most of the people adapt to it. The generations born into the socialist system cannot conceive of things being otherwise. They expect and demand that the state should look after them. This gives them a sense of security. They feel that egalitarian principles are being strongly applied in this respect.¹¹

Socialism's provision of basic security, deriving from guaranteed state care and the application of egalitarian principles are popular with much of the public. That is one reason why many people support the socialist system, despite its grave violations of human rights, brutal repression, and the wretched state of the economies. Many other citizens experience mixed feelings about a particular regime, hating what they reject while respecting the convenient or comfortable elements they want to retain.

How the antipathy compares with the sympathy and the hatred with the desire to retain elements of the system vary from country to country and period to period. Whatever the case, the welfare functions of the socialist state are the ones that will leave the most positive collective memories after the change of system.

Even in countries that never abandoned a market economy, based on private ownership or a democratic political system, and never followed the detour of building and then dismantling a communist system find that reforming the welfare state is a bitter struggle. Mature, rich welfare states, not just premature ones, can no longer bear the fiscal burdens of the accustomed, institutionalized services. The otherwise welcome increase in people's life spans is changing the age distribution of the population in favor of the old at the expense of the young, which steadily increases the costs of health and pension systems. It becomes imperative to place limits on future increases in such costs, but any move to do so meets with protest. Think of the enraged public opposition in France and Germany to reforms of the pension and health insurance systems and associated cuts in state-financed services. If these are the reactions of the public in rich countries, what can be expected in less developed countries, where the poorer strata are even more dependent on state assistance? If economic reformers put violent hands on the paternalist facets of the socialist system, they will increase the nostalgia felt for the old order. Reform of welfare-state activity needs to be handled with caution, if only out of political expediency and a desire to promote political stability in and sympathy for the new system.

Many of the welfare activities in some countries are performed by state-owned enterprises, not central or local organizations of the state. The firm runs a kindergarten and a doctor's surgery, pays off the pensions

of its former employees, and so on. In China it was especially common, as state assets were shed, new ownership relations developed, and the profit motive strengthened, for firms simply to cease meeting such welfare obligations. For example, after a company's kindergarten closed, the children were not admitted to a village or town kindergarten. Concerns for human welfare and political stability alike require that privatization should be coordinated with the transfer of such welfare functions, partly to central and local governments and partly to commercial, market-oriented organizations. There should not be gaps in the provision of welfare services.

I cannot offer a universal prescription for reforming the welfare state inherited from the socialist system, not least because there are fundamental value choices behind the possible measures of reform, here perhaps more than anywhere (Kornai and Eggleston 2001; World Bank 1994; Culyer and Newhouse 2000). Let us agree to respect *individual freedom of choice*. Individuals or families should be free to decide what health and pension insurance they will subscribe to and which kindergarten, school, or university they will send their children to. The more consistently (and exclusively) society seeks to apply the principle of individual sovereignty, the more favor should be given to decentralized, market solutions in all the sectors mentioned. At the same time, most people have a sense of *solidarity* with those in a disadvantageous position, who are not capable of paying out of their own pockets the costs they will incur if they are in trouble—they cannot purchase adequate medical insurance or pension schemes out of their incomes or pay university fees for their children. The more consistently (and exclusively) society seeks to apply the principle of solidarity, the more favor should be given to state redistribution and the paternalist solution. Furthermore, economic theory confirms that market failures occur in many segments of the sectors mentioned. Damaging cases of asymmetric information and adverse selection appear, impeding the operation of the market. This also becomes an argument for state intervention and redistribution.

The contradictions between values and the differences of interest among groups, strata, and generations of the public explain why reform of the welfare state proceeds with such difficulty. For my part, I believe in judicious compromise. Let there be egalitarian provision up to a cer-

tain level—basic health care and education for all and a minimum pension guaranteed for all old people. People should pay for what they desire beyond that and not expect the state to foot the bill. This line of thinking suggests there should be parallel systems operating and augmenting each other: state pensions and private pensions, state-financed basic medical care and private medical care, and so on.

A proposal that satisfies no one completely and requires concessions, insight, and tact from all may be ignored during vehement clashes between ideologies and interests. In all likelihood, the warring forces will block each other's efforts, and reform will come to a standstill. This can be seen in several post-socialist countries. (It can also be seen in the developed world, for example, in the breakdown or halting progress of health care reform in the United States.)

Concluding Remarks

In conclusion, I would like to touch briefly on two questions: First, in devising a program of transition, what role is played by the facts that the country concerned is extremely backward economically and many of its inhabitants are very poor? This, of course, has to be considered fully when every single decision is taken. Many economic problems obviously present themselves differently in Cuba, for example, than they did during the post-communist transformations of East Germany and Czechoslovakia. That was what I had in mind when I drew attention in this study primarily to issues *not* closely tied to level of economic development. Readers can convince themselves of this by leafing back. The peaceful or violent nature of the transition, the problem of justice, the forms of privatization, and so on are connected in the main with political and ethical positions.

I have pointed repeatedly to the *trade-offs* of the transition, the dilemmas and complex problems that oppose effective introduction of some measure of reform and the possible social and political consequences of introducing them. It has to be considered when weighing the latter that the consequences are borne by people who have suffered much already, not only from political oppression, but from material poverty as well. Decision makers have to think twice about what burdens they personally are able to bear in the present for the sake of a better future and

what burdens they are willing to impose upon others.

Second, my other remark concerns the role of advisers. I had studied the position of Cuba earlier, and I tried to gain more information as I set about writing this piece. Yet I have intentionally refrained from pronouncing on Cuba's specific problems or giving practical advice on what Cuba should do if post-socialist transition comes on the agenda. What should be done is up to the Cubans themselves to decide. Only they have the local knowledge required; they have to take the responsibility for and live with the consequences of their decisions.

I saw and heard from inside, as a citizen of a post-socialist country, what domestic experts thought of foreign advisers who had superficial knowledge of conditions in the country, confidently stating what should be done, based on experience elsewhere. The repellent intellectual arrogance of such advisers meant their advice was usually ignored.

I have visited many post-socialist countries, but I have refrained from advising, even if asked to do so. I have confined myself to talking frankly about our experiences and, above all, about the dilemmas, conflicting group interests, political considerations, and value choices we have encountered.

I have tried to do the same here. I should like those devising a working plan for a post-socialist transition in Cuba to work hard on certain problems, not to ignore them. I hope they will not be fooled by false prophets and advocates of extreme ideas. Let the designers of the transformation insist on confronting the arguments on each side and weighing the pros and cons. Let them evaluate thoroughly the social and political consequences of each new regulation or reform. And to add a hope that has lain behind every section of this paper, let them face the ethical implications and ask themselves: What values will be promoted or damaged by this regulation or that reform measure?

I would like to hope that this contribution has achieved this modest purpose. I do not want to suppress the bitter reflection that leaders of one nation's political life show little inclination to learn from other nations' experiences. They tend toward the same, avoidable mistakes that caused trouble elsewhere. I sincerely hope this will not happen in Cuba. The stock of experience is ample and well worth learning from.

TABLE 1. SURVEY OF COUNTRIES THAT COUNTED AS “SOCIALIST COUNTRIES” IN 1987

| 1 <i>Serial Number^a</i> | 2 <i>Country</i> | 3 <i>Serial Number</i> | 4 <i>COUNTRY</i> | 5 <i>Population, (million)^b</i> | 6 <i>Area, 2002 (1,000 sq. km)^b</i> | 7 <i>Political system classification, 2000^c</i> | 8 <i>Ownership reform (share of private sector in GDP) % in 2001)^d</i> |
|---|---------------------|---------------------------|--------------------------------|---|---|---|--|
| 1. | Soviet Union | 1.1 | Armenia | 3.1 | 29.8 | DEM | Large |
| | | 1.2 | Azerbaijan | 8.1 | 86.6 | AR | Large |
| | | 1.3 | Belarus | 10.0 | 207.6 | AR | Small |
| | | 1.4 | Estonia | 1.4 | 45.2 | DEM | Large |
| | | 1.5 | Georgia | 5.4 | 69.7 | DEM | Large |
| | | 1.6 | Kazakhstan | 14.8 | 2,717.3 | AR | Large |
| | | 1.7 | Kyrgyzstan | 4.7 | 198.5 | DEM | Large |
| | | 1.8 | Latvia | 2.4 | 64.6 | DEM | Large |
| | | 1.9 | Lithuania | 3.5 | 65.2 | DEM | Large |
| | | 1.10 | Moldova | 3.6 | 33.8 | DEM | Medium |
| | | 1.11 | Russia | 145.4 | 17,075.2 | DEM | Large |
| | | 1.12 | Turkmenistan | 5.4 | 488.1 | AR | Small |
| | | 1.13 | Ukraine | 49.3 | 603.7 | DEM | Large |
| | | 1.14 | Uzbekistan | 25.0 | 447.4 | AR | Medium |
| 2. | Mongolia | 2 | Mongolia | 2.7 | 1,565 | DEM | - |
| 3. | Albania | 3 | Albania | 3.4 | 29 | DEM | Large |
| 4. | Yúgoslavia | 4.1 | Boznia and Herzegovina | 4.3 | 51.1 | P | Medium |
| | | 4.2 | Croatia | 4.4 | 56.5 | DEM | Large |
| | | 4.3 | SU of Serbia and Montenegro | 8.6 | 102.4 | AR | Medium |
| | | 4.4 | FYR Macedonia | 2.0 | 25.3 | DEM | Large |
| | | 4.5 | Slovenia | 2.0 | 20.3 | DEM | Large |
| 5. | Bulgaria | 5 | Bulgaria | 8.1 | 111 | DEM | Large |
| 6. | Czechoslovakia | 6.1 | Czech Republic | 10.3 | 78.7 | DEM | Large |

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| 1 <i>Serial Number</i> ^a | 2 <i>Country</i> | 3 Serial Number | 4 COUNTRY | 5 Population, (million) ^b | 6 Area, 2002 (1,000 sq. km) ^b | 7 Political system classification, 2000 ^c | 8 Ownership reform (share of private sector in GDP) % in 2001) ^d |
|--|---|--------------------|----------------------|--|--|---|--|
| 7. | Hungary | 6.2 | Slovakia | 5.4 | 48.9 | DEM | Large |
| 8. | Poland | 7. | Hungary | 10.2 | 93 | DEM | Large |
| 9. | Romania | 8. | Poland | 38.7 | 313 | DEM | Large |
| 10. | North Korea | 9. | Romania | 22.4 | 238 | DEM | Large |
| 11. | China | 10. | North Korea | 22 | 121 | TOT | - |
| 12. | East Germany | 11. | China | 1,287 | 9,561 | AR | Medium ^e |
| 13. | Vietnam | 12. | Germany ^f | 15.1 ^g | 108 | DEM | Large |
| 14. | Cuba | 13. | Vietnam | 81.6 | 330 | TOT | Medium ^b |
| 15. | Congo | 14. | Cuba | 11.3 | 115 | TOT | - |
| 16. | Somalia | 15. | Congo | 3.0 | 342 | AR | - |
| 17. | South Yemen | 16. | Somalia | 8.0 | 638 | AR | - |
| 18. | Benin | 17. | Yemen | 2.2 ⁱ | 333 | RDP ^h | Large ^h |
| 19. | Ethiopia | 18. | Benin | 7.0 | 113 | DEM | - |
| 20. | Angola | 19. | Ethiopia | 66.6 | 1,222 | AR | - |
| 21. | Kampuchea | 20. | Angola | 10.8 | 1,247 | AR | - |
| 22. | Laos | 21. | Cambodia | 1.3 | 181 | RDP | - |
| 23. | Mozambique | 22. | Laos | 5.9 | 237 | TOT | - |
| 24. | Afghanistan | 23. | Mozambique | 17.5 | 237 | DEM | - |
| 25. | Nicaragua | 24. | Afghanistan | 28.7 | 648 | RDP ^h | - |
| 26. | Zimbabwe | 25. | Nicaragua | 5.1 | 130 | DEM | - |
| 1-26. | All countries counted as "socialist" in 1987 as a percentage of world total | 26. | Zimbabwe | 12.6 | 391 | RDP | - |
| | | | | 31.8 | 30.7 | | |

- ^a In Kornai, 1992, the order of the countries followed the date of their shift away from capitalism (e.g., date of communist takeover).
- ^b Source: CIA 2002. Population data show the last official census in each country.
- ^c Source: Freedom House 2002. Abbreviated notations (defined as in the text of the Freedom House survey):
- TOT = Totalitarian regime (one-party system that establishes effective control over most aspects of information, engages in propaganda, controls civic life, and intrudes into private life)
- AR = Authoritarian regime (typically one-party state or military dictatorship in which there are significant human rights violations)
- P = Protectorate (a country that has by its own initiative sought the protection of a more powerful neighboring state or is under the temporary protection and jurisdiction of the international community)
- RDP = Restricted democratic practice (primarily a regime in which a dominant ruling party controls the levers of power, including access to the media, and the electoral process in ways that preclude a meaningful challenge to its political hegemony)
- DEM = Democracy (a political system whose leaders are elected in competitive multi-party and multi-candidate processes, in which opposition parties have a legitimate chance of attaining power or participating in power)
- ^d This classification is primarily based on the data in EBRD 2003. Notations:
- | | |
|--------|-----------------|
| Large | = 60—100% |
| Medium | = 30—59% |
| Small | = less than 29% |
- = Missing from the analysis, not classified
- ^e 1998 data (37%). Source: Yang 1999.
- ^f The former German Democratic Republic became part of the unified Federal Republic of Germany.
- ^g 2000 data. Source: Federal Statistical Office of Germany 2003.
- ^h 2000 data (35.7%). Source: Statistical Office of Vietnam 2002.
- ⁱ Population in 1986. Source: Table 1 in Kornai 1992.
- ^j Since North and South Yemen united in 1990, this classification corresponds to the new united Yemen's political structure.
- ^k Source: World Bank 2003.
- ^l Here the Freedom House appraisal is out-dated. The RDP category is only a crude approximation of the present complicated and transitional political situation.

Notes

*I am grateful to Brian McLean for the excellent translation, to Julia Parti and Kathleen Hamman for the careful editing of the text, and to János Varga for his devoted research assistance.

¹ Kornai 1992, 6-7. The book treats the expressions “socialist system” and “communist system” as synonymous.

² Unfortunately, data on the share of the private sector in a subset of countries are missing. According to the impressions gained by experts, the role of the private sector became significantly larger in those countries as well.

³ It is another matter that they still rule dictatorially and repress political freedoms, for in that they are not alone. There have been and remain elsewhere many pro-capitalist, anti-socialist parties that enjoy a political monopoly and seek to retain it at all costs.

⁴ “Post-socialist transformation” has been defined several ways by different authors. A question to ask here concerns their view on what marks completion of the transformation. Those interested in the definition I use may consult my study, Kornai 2000b.

⁵ I submitted my proposals at the very beginning of the post-socialist transition in Eastern Europe. (See my book Kornai 1990, in English. This work has also been translated into Spanish, Kornai 1991.) After the first decade of the transition, I returned to the issue and confirmed my original position, Kornai 2000a).

⁶ The reports of the EBRD (2000, 2001) and the World Bank (2002) are rich in information and in appraisals of private-sector development and privatization.

⁷ I have underlined the ethical implications here. There also arise the incentive problems well known from the literature on “self-management”

and “worker management.” Can the workforce withstand the temptation to hike its own wages? Can working discipline be maintained? See Roland 2000; Filatotchev, Wright, and Bleaney 1999; and Frydman, Gray, and Rapaczynski 1996.

⁸ Frydman, Gray, and Rapaczynski (1999) add a further important consideration: the distinction between insiders and outsiders as potential buyers of state-owned assets. Sale to outsiders has significant advantages from the point of view of the future efficiency of the firm.

⁹ At this point, it may be useful to explain how privatization actually can be undertaken: (1) There are small firms, which could be sold easily. That is called “small privatization.” (2) Larger, state-owned firms should be transformed into joint-stock companies. No need to sell the whole company to one single person. You can sell shares in small packages. (3) Credit and amortization schemes can be introduced. After a small down payment, a repayment schedule can be extended over many years. (4) There is no need to hurry. In a few years, private wealth will accumulate in the hands of successful managers, small business people, and others, and they will be able to buy more shares. These four suggestions are not mutually exclusive and can be applied side-by-side.

¹⁰ The contract may impose, beside the price, other conditions on the buyer, concerning employment, technical reconstruction, investment, and cessation of environmental damage, for instance. It is another matter that costs placed on the new owner may justify a lower selling price for the assets.

¹¹ They are not applied consistently, for the upper ranks of the *nomenklatura* have privileges: special health-care facilities, easy university admission for their children, and so on.

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ABOUT THE AUTHOR

János Kornai is Allie S. Freed Professor of Economics Emeritus at Harvard University.

Professor Kornai was born in Budapest, Hungary, in 1928. He studied history and philosophy at Budapest University. After his appointment in 1986 as Professor of Economics at Harvard University until his retirement in 2002, he divided his time between Cambridge, Massachusetts, and Budapest, Hungary, where he served as research professor at the Institute of Economics of the Hungarian Academy of Sciences until 1992. At that time, he became a permanent fellow of the newly established Collegium Budapest, Institute for Advanced Study.

Professor Kornai's first encounter with economics was his appointment as economics editor of a daily newspaper with the largest circulation in Hungary, which required that he observe the socialist economy from within. In 1955, he entered the newly founded Institute of Economics of the Hungarian Academy of Sciences, and in the following year his book, *Overcentralization of Economic Administration*, was published. His was the first critical book on the command economy written by an "insider," that is, by a citizen of a communist state. The book was his Ph.D. thesis.

In the late 1950s, he was among those initiating the use of mathematical methods in socialist planning. He elaborated the theory of two-level planning with Tamás Lipták and directed the first large-scale, economy-wide, multi-level planning project. Experiencing the limits of planning led him to an increasing interest in theoretical foundations. *Anti-Equilibrium* (1971), a controversial essay criticizing Walrasian neoclassical economics, suggested new approaches to studying chronic non-Walrasian states and price- and non-price signals. In his personal intellectual development, this book was a preparation for the task that followed: enquiry into the nature of socialist systems. Issues such as chronic shortages, forced growth, the soft budget constraint syndrome, bureaucratization, and conflicts between socialist principles and efficiency became his main concerns. These studies resulted in a number of journal articles and a monograph, *Economics of Shortage* (1980), perhaps his most influential work, which has been translated into many languages,

including 100,000 copies printed in Chinese. The monograph demonstrates that chronic shortages are not the consequences of planners' errors or the wrong prices; rather, they are systemic—the inevitable consequences of the “classical” communist system.

Professor Kornai started work in 1988 on a book summarizing his life's study of socialism, published in 1992 as *The Socialist System. The Political Economy of Communism*. It presents a synthetic analysis of the political, social, and economic attributes of the system. At the same time, he turned his attention to the task of analyzing post-socialist transition and formulating policy recommendations. His book, *The Road to a Free Economy* (Hungarian version, 1989; English version, 1990), published in seventeen languages, was a pioneering study of stabilization, liberalization, and privatization. Many of his subsequent writings dealt with the macroeconomic aspects of transition and the interaction between politics and economic policy in the period of post-socialist transition. These writings were published in two volumes, *Highway and Byways* (1995) and *Struggle and Hope* (1997). He also produced several studies on the reform of the welfare system and summarized these views in the book, *Welfare, Choice, and Solidarity in Transition* (2001), coauthored by health economist Karen Eggleston, a former student of his at Harvard.

Professor Kornai's recent work has centered on issues concerning the redefinition of the role of the state in a post-socialist society in general and reforming the state's activities in the area of social policy in particular. Recently, he co-directed with Professor Susan Rose-Ackerman (Yale) a comprehensive research project, *Honesty and Trust in the Light of Post-Socialist Transition*, at Collegium Budapest, where he is an emeritus fellow.

Professor Kornai's works have been translated into Arabic, Bulgarian, Chinese, Czech, Croatian, English, Estonian, French, German, Greek, Hebrew, Italian, Japanese, Polish, Portuguese, Romanian, Russian, Serbian, Singhalese, Slovak, Spanish, Tamil, Ukrainian, and Vietnamese.

Professor Kornai's early monograph, *Overcentralization*, created a stir in the West, and from 1958 onward he received many invitations to visit foreign institutions. However, he was denied a passport by the Hungarian authorities and was not allowed to travel until 1963, when

political repression had begun to ease. He has had several visiting appointments at universities in the United States and elsewhere, including the London School of Economics, Stanford, Yale, Princeton, and Geneva, Munich, and Stockholm Universities.

He has also received honorary doctorates from the universities of Paris, London, Amsterdam, Budapest, Poznan, Wroclaw, Torino, Debrecen, Stockholm, Varna, Pecs, and Veszprem. He is a Member of the Hungarian Academy of Sciences and the European Academy; a Foreign Member of the American, British, Swedish, Finnish, and Russian Academies; and an Honorary Member of the American Economic Association and the European Association for Comparative Economic Studies. He was awarded the State Prize, the Academic Award, and the Széchenyi Prize in Hungary; the Humboldt Prize in Germany; and the Seidman Award in the United States. He became Officer of the Ordre National de la Légion d'Honneur and was awarded the Commander's Cross of the Hungarian Republic.

Professor Kornai served as President of the Econometric Society in 1978 and President of the European Economic Association in 1987. He served as a member of the Board of the National Bank of Hungary, the Hungarian central bank from 1995 to 2001, and was elected President of the International Economic Association in 2002.

János Kornai is married to economist Zsuzsa D-niel. They have three children and seven grandchildren.

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