Restructuring Cuba's public sector: an international perspective

Professor Manfred Bienefeld
School of Public Policy and Administration
Carleton University, Ottawa, Canada
manfred_bienefeld@carleton.ca

Introduction and Overview

As Cuba faces the challenge of deepening its links with the international economy it must confront the difficult task of adjusting its domestic policy process to deal with these changes. And this will be no easy task, because as Cuba's links with the external world proliferate, that policy process will become more complex. External factors will come to have a greater impact on the Cuban economy and Cuban society and new, potentially very powerful voices will come to play a role on the domestic stage.

Of course, this relative opening to the outside world will also bring benefits, and these may turn out to be much larger than the costs - in the short run and maybe even in the longer term. But this cannot be taken for granted and much will depend on how the Cuban government handles the transition and how the international community responds to its initiatives. Undoubtedly this transition entails enormous risks that need to be carefully assessed and managed. Indeed, the greatest challenge facing Cuba's policy makers today, is that of finding ways of weighing those potential costs and risks against the potential benefits. And of doing this explicitly and transparently enough that their ultimate policy choices can hope to have a reasonable chance of commanding the broad support of the Cuban people.

This paper is not about the choices that Cuba should make in this situation. That is a matter to be determined through the Cuban political process: because it is the Cuban people who have to live with the consequences; because the choices that have to be made are highly uncertain and carry different risks for different groups in the population; and because those choices ultimately need to be based on certain values, principles and priorities that must be shaped and legitimated by a domestic political process. This means that there is no 'correct' decision for Cuba in this situation. And that outside experts, or the institutions that they represent, should not be taken seriously when they claim to know 'the answers' to the questions facing Cuba. They do not. And what they do know, needs to be examined carefully in light of the values, the interests and the incentive structures that shape the work that they do.

In this context, this paper will seek to make a small contribution to the discussion of what Cuba can learn from the world's most vocal international 'experts' and institutions with respect to the critical question of public service reform. What can it learn from these mainstream sources about how to restructure its state institutions and its bureaucracy in order to strengthen its policy processes by enhancing participation and transparency; or in order to increase the 'efficiency' of the public sector; or, ultimately, in order to enhance the development prospects of a more internationally integrated Cuba? The point is not to make recommendations, or to prescribe policies for Cuba. It is rather to allow Cubans to make better choices by discussing some of the problems and contradictions embedded in much of the international debate about these issues.

Three main themes will emerge from this discussion. The first theme addresses the context within which the demand for the radical restructuring of states has emerged in both the developed, and the developing, world. Here the discussion focuses on the fact that this entire debate was essentially derivative, effectively – and logically – arising as a simple corollary of certain widely hailed conclusions about desirable, and undesirable, 'development models.' It follows, therefore, that if these 'prior' conclusions about desirable development models turn out to be weak and contested, then the discussion of appropriate state forms, and of public sector reforms, has to be broadened and expanded accordingly.

The second theme deals with the uneasy relationship between science ('social science') and ideology in the 'public management' debate. Here attention is first drawn to the methodological problems that arise because most of this debate uses the neoclassical concept of efficiency rather uncritically as the yardstick by which to measure social – and public sector – efficiency. A case is then made to suggest that there are strong grounds for arguing that it would be more desirable – and more defensible – to base these discussions on some variant of institutional economics. The conclusion is that if this were done, the question of what constitutes 'desirable public sector reform' would have to be considered in a very different light.

Finally the third theme addresses the problems that arise as a result of the fact that the mainstream debate about public sector reform is deeply rooted in 'public choice theory,' which also imposes severe methodological limitations, or distortions, on the resulting discussion. Because that theory effectively eliminates – *by definition* - some critically important aspects of the political process from consideration, it leaves us to look at the question of state reform through a distorted, ideological lens.

This, in turn, leads to the fourth and final theme, which considers the powerful interests that are reflected – and embedded – in these mainstream debates. When considered from this perspective, both theory and evidence provide good grounds for the belief that the 'attack on the state,' which has been at the centre of the crusade to reform public sectors over the past thirty years, has been strongly driven by ideology, in part because it served private corporate interests, and interests of international finance, so spectacularly well.

The final section of the paper cautions that, even if all of the above concerns were to turn out to be legitimate and well founded analytically, this would not have clear, unambiguous policy implications for Cuba. And this is shown to be so because policy has to be made in the real world where policy choices have consequences - in the form of positive and negative reactions from 'other actors.' In other words, the real world is a world where 'strategic behaviour' predominates. And in such a world the insights gained from the above analysis could lead to diametrically opposite conclusions. Which is why those policy choices ultimately have to be made by the Cuban people and their government.

The historical and analytical roots of today's development 'orthodoxy'

To understand the context within which today's demands for 'state reform' have arisen, it is necessary to understand the evolution of the 'development debate' after WW II. That debate has witnessed a radical shift from a majority view which ascribed a leading and formative role to the state in the development process, to one which ascribes an even more dominant role to private corporations, and to financial institutions, guiding resources through liberal international markets. To make sense of current demands for state reform, and current advice as to how states should be constructed, or rather 'reconstructed,' it is therefore necessary to understand the reasons for, and the legitimacy of, this dramatic shift. In other words, before one addresses the detailed question of how state structures should be reforms, it is essential to decide what role these states should play – in society and in the economy. Of course, it has been widely suggested that this debate is essentially over since all 'competent, objective observers' now agree with the neoliberal view that states should play only a minor, facilitating role in development[1], that claim . But that claim is not defensible

When WW II drew to a close and decolonisation spawned innumerable global movements of national independence the central focus was on the need for societies to 'take control' of their own affairs; to seize the power to shape their future in accordance with their own values and priorities; and to take control of their resources and their economies in order to build the foundations for prosperity and liberty. That was the dream, but that was more than two generations ago.

In the early stages of this process it was almost universally agreed that because these societies were deficient in skills, in infrastructure, in technology and in the institutions that might allow them to prosper in the hurly burly of the international economy, they had to move forward slowly and cautiously. And so the 'development debate' began by assuming, almost unanimously, that in such situations states had to play a leading role in building the foundations for a society's 'modern' future. And, as a corollary, it was equally universally assumed that such states had to protect their economies for significant periods of time from the full glare of international competition, so that they could create an economic space within which to encourage the development of domestic capabilities, technologies and institutions.

In other words, the debate was not about whether this was the right approach to the development challenge. It was rather about the form that this state led development process should take, and the speed with which it should proceed. Almost everyone, including the embryonic international development agencies, that came to be led by the International Bank for Reconstruction and Development (also known as the 'World Bank')[2] from the late 1950s onwards, accepted import substitution as a central and critically important part of the development process. And this was the view that was supported and financed by the international agencies, and the international experts, of the day. And, of course, they generally had the enthusiastic support of national governments and policy makers, who were only too pleased to be given such power, and such an important role in history.

Moreover, it is not difficult to understand this virtual unanimity of view. After all, few people doubted that skills, and institutions and technologies had to be built if societies and economies were to 'engage' the world economy on terms that would bring their people sustained and cumulative benefits. And almost everyone could agree that this was not likely to happen if foreign goods were given immediate unlimited access to the domestic market, or if foreign interests were given immediate and full access to domestic resources and markets. In both cases it was assumed that such a 'premature'

[1] This was the crux of the so-called Washington Consensus which was defined by John Williamson in 1990 (Williamson 1990). Although its exact meaning is much debated and disputed, if only because it was formulated in such a vague and general manner, there can be no doubt that this 'Consensus' was widely used to narrow the debate by implying that anyone who disagreed with its assertions was, 'by definition,' incompetent or worse. declaring many important issues to be 'resolved' in the minds of 'serious' economists, at least.

[2] Of course it should be noted that the World Bank was not initially designed as a development institution, but as an institution to guide and to finance the reconstruction of Western Europe. Indeed, at the Bretton Woods meetings where it and the International Monetary Fund were established, the discussion was heavily dominated by the United States and the United Kingdom and the voices of the 'less developed world' (which was not yet 'a concept') were extremely muted. India did attempt to include an explicit concern with the less developed parts of the world in the World Bank's terms of reference, but this suggestion was heavily defeated because the powers that be were keenly aware that the resources needed for the reconstruction of Europe were already in excess of the resources they would be able to mobilise. (See Harold James 1996 for an excellent discussion.)

opening of the economy would lead to a destruction of domestic institutions and capabilities, as national firms, technologies and institutions were displaced by stronger, and more efficient, international firms. The consensus was, therefore, that great care had to be exercised in forging links between these fledgling economies and the aggressive, turbulent, fast paced international economy outside of their borders.[3]

Moreover, to fully appreciate this view it is important to understand that even within the industrial economies, the *laissez faire* policies of the late nineteenth century had been utterly discredited by the disasters that had befallen the world in the wake of the 1920s. Thus, as WW II came to an end, even powerful people understood - or feared - that capitalism might be threatened if the post-war world returned to the chronic instability of the twenties because it was now widely believed that this instability had led almost inexorably to increasing economic and social dislocation around the world, as unpayable mountains of debt made increasing numbers of economies and societies more and more unstable and unmanageable.

To many, the pre-war period now appeared like a Greek tragedy in which people – and nations – had doggedly and blindly pursued a certain course of action that had eventually assured disaster. Blinded by ideology, the had persisted in attempting to create a liberal, self-regulating international market, even though the consequences of their actions should have served as a reminder that markets will not, and cannot, function effectively in the public interest unless they are firmly embedded within clearly defined – and enforced – legal, institutional and normative frameworks which must be created, enforced and legitimised by some coherent, meaningful political process.

Unfortunately, in the absence of a global political process through which such a framework might be created and legitimated at the global level, the result of their efforts was bound to be disastrous *** because the powerful centrifugal tendencies of markets now came to the fore, fuelling instability, increasing inequality and allowing speculative forces in the world's financial markets to grow to such a degree that resources were more and more massively misallocated, ultimately leaving idle resources and unemployed armies of workers to mock the cries of the indigent and the needy, for coal, for food, for housing.

The truth is that in this process, international markets, and especially international financial markets came to be less and less firmly anchored in 'defined national realities' that could hope to manage or to regulate them effectively. And the worse things got, the more aggressively the liberal ideologues demanded that their liberal medicine must be applied even more rigorously, more forcefully, more comprehensively – whatever the evidence may say. Short term pain had to be accepted, for hypothetical long term gain. But it turned out that neither the depth, nor the duration, of that pain could be specified. And, as time went on, it became apparent that the liberal ideologues would 'accept' any amount of pain, for any length of time, though, of course, always on behalf of other

[3] This view goes back at least to the nineteenth century German economist Friedrich List who argued that David Ricardo's theory of free trade as 'the theory of the strong' (List 1904); and that its acceptance by Germany would condemn it for ever to a secondary supplier of wheat and of simple products to Great Britain, in exchange for the latter's increasingly sophisticated industrial products. In his view, this would be so because Great Britain's existing technological dominance could – and would - be used to stifle – or to destroy – any potential competing technologies or firms that might otherwise arise within Germany. Moreover, Germany's rapid rise as an industrial power to challenge Britain in many industrial areas by the early twentieth century, was fashioned on the basis of nationally oriented policies that were rooted in this perspective. And later, Japan would become a major industrial power following 'the German strategy;' and later still, South Korea and Taiwan would do the same, following a 'Japanese strategy.'

people, since the experts who were making these pronouncements rarely suffered much of that pain they were so glibly accepting.

Karl Polanyi captured the manic absurdity of this process in his seminal book The Great Transformation, written before WW II had ended (Polanyi 1944). Having described the 'orgy of creative financing' that had led to massive unmanageable debts by the late twenties, he explains that how this had led to increasingly destructive contradictions because insistence on repayment increasingly came to threaten to destroy the borrowers, while failure to repay, increasingly threatened the stability of the financial system. In response:

> 'Economic liberalism made a supreme bid to restore the self-regulation of the system by eliminating all interventionist policies which interfered with the freedom of markets for land, labor, and money. It undertook no less than to solve, in an emergency, the secular problem involved in the three fundamental principles of free trade, a free labor market, and a freely functioning gold standard. It became, in effect, the spearhead of a heroic attempt to restore world trade, remove all avoidable hindrances to the mobility of labor, and reconstruct stable exchanges. This last aim had precedence over the rest. For unless confidence in the currencies was restored, the mechanisms of the market could not function ..'(Polanyi 1944:231)

But from Polanyi's perspective, this crusade, which was aggressively led by the Geneva based institutions of the League of Nations, was always bound to fail. Indeed, the more fervently it was pursued, the more spectacular the eventual collapse would be because, in the process, national regulatory capabilities were effectively being undermined, at the same time as irrational speculative forces were being strengthened in the world's financial markets. And so Polanyi concludes that:

> 'The achievement of Geneva was remarkable in its way. Had the aim not been intrinsically impossible, it would have been surely attained, so able, sustained, and single-minded was the attempt. As matters stood, no intervention was probably more disastrous in its results than that of Geneva. Just because it always appeared to be almost successful, it aggravated enormously the effects of the ultimate failure.' (Polanyi 1944:)

This was the background against which to understand the strong post-war consensus around the need for effectively regulated and socially embedded markets, and for active and relatively interventionist states, not just in the newly independent countries, but also in the 'developed,' industrial world. Writing in 1948, Nobel Laureate Arthur Lewis described the situation prevailing at that time as follows:

All of this began to change in the course of the sixties, and the changes accelerated in the seventies, as the original Bretton Woods system was torn apart by a number of chronic and persistent imbalances[4], whose impact was amplified by the re-emergence of large international flows of short

[4] The most prominent of these was generally referred to as 'the dollar overhang' and referred to the enormous accumulation of US dollars that had accumulated since the war when US dollar exports had provided the world economy with sufficient liquidity for rapid international growth. However, by the late sixties, the US's trade surplus, which had financed these outflows, began to dwindle, putting downward pressure on the dollar and thereby reducing the willingness of Central Banks everywhere to hold large amounts of dollars in their reserves. By 1971 the dollar's link with gold was severed when President Nixon announced that the US would no longer willing to exchange for gold at $35 an ounce, the price that had been fixed when the Bretton Woods agreement was first signed. The other critically important imbalances took the form of the persistent trade surpluses run by both Germany and Japan from the late sixties. And, of course, the alleged – though

term finance. By the late seventies, the ‘golden age’ that had prevailed for a quarter century until 1973, was but a distant memory. By now all of the safeguards that the original architects of Bretton Woods had been so anxious to put into place, were either gone, or on their way out. Managed exchange rates had largely given way to market determined rates; capital controls were rapidly being undermined, not least by the explosive growth of the Eurocurrency markets which created credit outside of the control of any national authorities; and the link between the US dollar and gold had been broken, creating a world economy based on ‘pure fiat money’ for the first time in history.

The result was just what the architects of Bretton Woods would have expected. The world economy became much more volatile, growth slowed significantly, inequality increased and persistent levels of high unemployment re-emerged in many industrial countries. Perhaps most significantly, financial instability and serious financial crises, which had been all but unknown for a quarter century, became endemic once more. And there is evidence to suggest that they are increasing in frequency (Caprio and Klingebiel 1997). Moreover, these crises are known to ‘have severe macroeconomic consequences,’ reducing growth and undermining macroeconomic stability (Stiglitz 1998:14).

In important respects, the world has returned to square one as Krugman, writing in 1999 suggests, when he says that ‘recent events may not have repeated those if the 1930s, but they do rhyme.’ (Krugman 1999:xix) The truth is that some vitally important lessons of history that were embedded in the original Bretton Woods system, have been forgotten (Bienefeld 1988). And the world is paying a high price for this return to the past. Moreover, there are good reasons to believe that, as in the twenties, the unleashing of the dark forces of speculation in the world’s financial markets may be creating ever more intractable problems[5], as debt mountains grow increasingly unmanageable[6]; as vast amounts of investible resources are misallocated[7], and as the global financial system becomes ever more complex and opaque, raising the spectre of ‘systemic risks,’ which arises because the growth of a phenomenally dense, largely unknown and virtually incomprehensible network of linkages and feed

---

fictitious - imbalance between supply and demand for oil, which led to the oil crisis that ‘changed the world’ in many important ways.

[5] In his penetrating book The Return of Depression Economics, Paul Krugman warns that we have now re-created conditions in which a protracted ‘depression’ must once again be considered a real possibility because various imbalances have now grown so large that standard policy measures have become ineffective – and dangerous. Which is why ‘… the world is lurching from crisis to crisis, all of them crucially involving the problem of generating sufficient demand … [while] one developing country after another has experienced a recession that at least temporarily undoes years of economic progress, and finds that the conventional policy responses only make things worse. … [Moreover] … what is particularly poignant about the economic crises of the last two years is that by and large the countries caught up in them were, by all accounts, following *better* policies than they had in the past.’ (Krugman 2000:156, 159)

[6] The 1930s spawned an enormous literature, and not a few political movements, focusing on the evils and dangers of debt and credit finance. And for good reason. The truth is that an excessive build up of unsustainable financial claims will create pressures that may become simply unmanageable. This may be either because the real world simply cannot ‘deliver’ on those outstanding claims no matter how radically it is ‘restructured’ to give overriding priority to debt repayment – as evidenced by the failure of IMF/World Bank ‘structural adjustment’ policies to solve the Third World debt crisis (Bienefeld 2000). Or it may be because the ultimate inability of ‘the real world’ to meet those outstanding financial claims leads to a ‘systemic collapse’ in the financial sector, as the ‘miracle’ of leveraging begins to work in reverse.

[7] The recent spectacular collapse of the ‘dot.com bubble’ is merely the latest in a lengthening string of ‘bubbles’ that have misallocated vast amounts of resources and imposed enormous hardship and cost on the world economy. But, even though almost ‘everyone’ acknowledge these ‘mistakes,’ most of these crisis have led to ‘solutions’ that have given even more power to the financial markets that are at the root of the problem. Thus, most of Asia’s financial markets were dramatically liberalised in the wake of the 1997/98 crisis, though, as always, with the promise that ‘better regulation’ and ‘more transparency’ would curb future instability. But there is little reason to take such promises seriously, as the same promises have been made after every recent crisis, but the effect has been negligible. The real truth is that ‘modern financial markets, by creating many institutions that perform bank-like functions but do not benefit from bank-type safety nets, have in facet reinvented the possibility of traditional financial panics.’ (Krugman 1999:162)

back loops has created a situation in which it is feared that an exogenous shock – or a systemic aberration? – could be amplified, rather than being absorbed or diffused, by those financial markets. (Corrigan 1993)

But not only had the world come full circle, so had economic analysis and political thought. Indeed, the extent of this reversal is hard to exaggerate. Long 'discredited' economic theories, which held that 'markets ultimately knew best' were rehabilitated, largely on the basis of theoretical deductions from the 'perfect competition model.'[8] Deductions which provided the foundations for something called 'supply side economics,' which held that Keynesian concerns with demand management were irrelevant or worse, and which concluded that the main task of policy, and of governments, was to create favourable conditions within which market forces could work their magic. Although the evidence to support these claims was sketchy at best[9] they were gladly accepted, and endlessly repeated, especially by those who stood to gain from them so handsomely. In fact, Krugman has gone so far as to describe 'supply side economics' as 'a crank doctrine, which would have little influence if it did not appeal to the prejudices of editors and wealthy men.' (Krugman 1999:155)

The post-war consensus was now turned on its head. The state was no longer part of the solution, it was portrayed as 'the problem,'[10] and this soon became the defining, central pillar of the mainstream policy debate. Around the world, states were now to be downsized and restructured; their administrative apparatuses streamlined and reshaped; their procedures made more 'transparent' and accessible to the public. Efficiency and accountability were to be increased; state services contracted out; state powers restricted. Henceforth, states were supposed to steer, not row.[11]

But if 'supply side economics' can be described as a 'crank doctrine' then we must surely find an even stronger epithet for this part of the crusade to enthrone the market and the corporate and wealthy players who dominate it. The truth is that as in so many other areas[12], there was no systematic or persuasive evidence to justify the claim that the state was the central problem. And there was even less evidence to support the 'common sense platitudes' that made up most of the more detailed policy advice about state restructuring. And in the absence of such evidence, it is hard not to conclude that this

[8] Since this model defines the optimum outcome as 'the equilibrium that is produce by perfectly competitive markets' it is hardly surprising that it systematically supports the conclusion that it is 'better' to give more power to market forces. The fact that the real world does not remotely approximate the minimum conditions needed to support this conclusion is acknowledged but dismissed, either on the grounds that the model nevertheless allows us to understand how the real world works, or on the grounds that market failure may be bad, but government failure is even worse (Lal 1973). Both of these responses are essentially assertions based on faith, not statements with persuasive empirical , or scientific' backing.

[9] There is a considerable body of evidence documenting the fact that government intervention was often irrational and ineffective, and became more so in the course of the seventies and eighties. But most of this does not support 'supply side economics.' Indeed, it may merely reinforce the basic Keynesian view that rational and effective economic management becomes increasingly difficult, if not impossible, in the unstable, volatile, fundamentally irrational world that will inevitably come into existence if finance, and especially short term finance, can flow freely across borders.

[10] This phrase became rather common, especially after the publication of Deepak Lal's impassioned attack on the evils and fallacies of state *'dirigisme'* in 1973 (Lal 1973).

[11] This vague but evocative slogan was the main theme of the most fashionable cookbook for state restructuring consultants and short stay international experts dispensing the new wisdom in the benighted developing world, namely (xxxx)

[12] The truth is that when 'structural adjustment policies' were first introduced by the World Bank and the IMF, their own studies had concluded firmly that there was no evidence to support most of the claims at the heart of hat new policy regime. (Bienefeld 2000) This problem has been most evident with respect to the demand for financial liberalisation, which has been assiduously and aggressively promoted in the teeth of contrary evidence, echoing the fears of the architects of the original Bretton Woods. Joseph Stiglitz has recently stated flatly that 'there is no evidence' to support the claims that this process will increase efficiency, and even less that it will lead to macroeconomic stability. (Stiglitz xxx) Meanwhile And Jagdish Bhagwati has recently And, with respect to financial liberalisation

was another doctrine which would have had little influence, if it had not appealed so powerfully corporate and financial interests who dreamed of creating a 'level global playing field,' free of awkward politically mediated pressures and constraints setting 'arbitrary' limits on their ability to be 'entrepreneurial' – whether by investing in productive activities or by speculating in the financial markets.

The central point is that the reversal of the postwar consensus that began in the late sixties and that was essentially completed by the late eighties, was dramatic; was not based on clear or persuasive evidence; and empowered the market and market actors, while disempowering public institutions and politically derived power. And this can only lead to the conclusion that this process was mainly driven by power and ideology[13].

The point is made especially graphically by Jagdish Bhagwati (Bhagwati 199x), when he suggested that, in view of the contrary evidence and the extent of the risks, the continued push for capital account liberalisation could only be explained by noting that these policies served the interests of a powerful 'Wall Street-Treasury complex' – though he should have added that this 'complex' includes the financial elites in every country, especially those in the poorer developing countries who do not wish to 'trapped' within their 'weak economies' but want to be free to act as 'global citizens' in the world's financial markets. Bhagwati concludes that: 'It is a lot of ideological humbug to say that without free portfolio capital mobility, somehow the world cannot function and growth rates will collapse.' (Bhagwati 1997 as cited in Damodaran 2000)

And so the world had indeed come full circle. The worst fears of the architects of Bretton Woods would appear to have come true. It seems we are condemned to repeat a very painful and destructive period of history. Let us hope that the end can be different.

What does it mean to say that the state is 'the problem'?

Making the case against the state is just too easy. Every state is highly imperfect and many states are chronically imperfect. Most states are ascribed roles and functions which they are unable to fulfill under existing conditions. And, as the global economy becomes more and more unstable and unmanageable, the 'buck always stops with the state.' At least, it stops with the state when things go wrong, though rarely when they go right. In large part this is because of the distorted ideological lens that is now generally used to view the public sector and the state.

In effect, we have now created a classic example of that 'rigged game' in which the operational rule is: "Heads I win; tails you lose.' Success is ascribed to the market, and apparent state success is qualified by noting that the market could probably have done even better, which is by now treated as an article of faith. On the other hand, when the market fails, even when it fails spectacularly, as in the case of the dot.com bubble, or the privatisation of California power, the disaster turns out to be the state's fault, because it did not regulate these industries as it should have done. If the issues were not so serious, this could almost seem funny.

Beneath this intellectual shell game there are deeper problems. At one level these can be seen as methodological problems. How is performance – whether private or public – is to be judged? If it is

[13] See Bienefeld 2000b; Damodaran 2000; Rodrik 1999; Stiglitz 1198; Wade and Veneroso 1998 for a fuller elaboration of this point.

judged on the basis of the neoclassical concept of efficiency, which defines the 'competitive market equilibrium' as the 'optimal' outcome, then the inherently relatively 'uncompetitive' public sector, or indeed 'the real world' which does not come close to meeting the conditions for perfect competition, is bound to come out badly by comparison. And this readily leads to the logical conclusion that one could move a little closer to the 'optimum' if one could increase the role of 'competitive markets' in society, which is why this 'Nirvana approach to economics'[14] tends to give some variant of the same answer to almost every policy question, namely deregulate markets, or restructure the state, to increase efficiency, to remove 'distortions' and to reduce 'welfare losses' by narrowing the alleged gap between the current situation and the 'Nirvana' of perfect competition. This, of course, is why so many development 'experts' feel able to give detailed advice on highly complex matters on the basis of very short 'research' visits. And why some are said to arrive in 'the country' with their recommendations already in their laptop computers.

But this approach to making policy for the real world is simply indefensible. The conditions for perfect competition do not exist in the real world, and some – like the one that 'perfect information must be available instantaneously and costlessly to all market actors at all times – are so absurd that they could not conceivably exist in any real world. Moreover, the theory of the second best[15] has clearly demonstrated that even if one accepts the 'competitive equilibrium' as a meaningful basis for defining 'efficiency,' it is absolutely indefensible to suggest that in a world with many 'imperfections'[16] the removal of some of these 'imperfections' will yield net welfare gains. In fact, the theory says that the impact on welfare will be indeterminate, so that neoclassical theory, as such, cannot be invoked to support the neoliberal policy advice that dominates the development debate, and that underpins the debate about state restructuring. Of course the state should be made 'more efficient' – but the neoclassical definition of efficiency is not a sensible, or even a meaningful, standard by which to measure that efficiency.

In fact the economic foundations of the policy debate need to move to en entirely different methodological terrain, namely to that of institutional economics which abandons the 'Nirvana' of perfect competition and grapples with the real world and its institutions. Instead of comparing real world outcomes to Nirvana, this 'is always and everywhere an exercise in comparative institutional analysis, comparing two or more feasible forms of organization.' (Williamson 1994:185) Moreover, its definition of efficiency is constructed rather differently. Instead of being linked to some notion of the 'optimum'[17] it is linked to the more realistic question: 'Can we do better?' Accordingly, in this economics[18]

---

[14] A phrase was used by Demsetz to refer to an economics that is centrally concerned with comparing the real world to a hypothetical 'competitive equilibrium' in order to measure 'distortions,' inefficiencies' and 'welfare losses.' (Demsetz 19xx)

[15] This was first developed by Lancaster and Lipsey (Lancaster and Lipsey 195x) and is well discussed in Lal 1973.

[16] The Alice in Wonderland quality of this terminology is worth noting – and understanding. A theory has been constructed on the basis of utterly unrealistic, even absurd, assumptions that bear little relation to the real world. A normal person might respond by saying that the theory has 'serious imperfections,' but those who trade in this 'voodoo' like to claim that it is the world that has many 'imperfections' – alas - and their 'view of the world' has become part of the 'hegemonic ideology' that defines how people see the world.

[17] In the real world an 'optimum' is a rather absurd notion precisely because circumstances are constantly changing and opaque, and because 'social welfare functions' exist only in the heads of a few – a very few – theoreticians. In reality, policy makers will generally be happy to focus on the much more modest task of trying to bring 'some improvement' to a situation. This turns out to be difficult enough.

[18] Williamson is specifically speaking of 'transaction cost economics' but what he says applies to the whole of institutional economics, which is a broad church, extending from the Austrian School of Hayek, maybe the most fervent supporter of the 'free market,' to Marxian political economy. This reflects both the strength and the weakness of this methodological approach. It deals with the real world in all of its complexity and, as a result, its conclusions are more contingent (on myriad

> 'the appropriate test of failure of all kinds – markets, bureaucracies, redistribution – is remediableness: *an outcome for which no feasible superior alternative can be described and implemented with net gains is presumed to be efficient.*' (Williamson 1994:185)

Of course, this does not 'solve' the analytical problem since one might well ask how one should define, or measure, the 'net gains' that one is trying to identify when applying this alternative approach. And to this there is no firm or universal answer. Indeed, the 'best' answer (there is no 'correct answer') needs to be determined as part of the policy process and will, therefore, reflect values, priorities and interests. That is why Mishan in his honest and pragmatic defense of neoclassical welfare economics (Mishan 1982) is forced to concede that the use of the neoclassical concept of efficiency is warranted only in societies that share accept the highly individualistic values on which it is based.

When we turn to the political science underpinnings of the literature about the restructuring of the state, the very same issues arise in that those same individualistic assumptions on which the edifice of neoclassical economics rests, were imported into political science to create something called 'public choice theory.' Here too one can paraphrase Krugman's remark about 'supply side economics' to suggest that this school of thought would surely have remained a marginal playground for itinerant economists if it had not happened to provide a political rationale for the 'disempowerment of the state' that was the necessary corollary of the crusade to empower the market.

The central and defining assumption of public choice theory is that 'the state is just another self interested actor' made up of self-interested individuals seeking to manipulate self-interested institutions to their own ends.[19] And since the public interest is merely an aggregation of individual interests, the notion of a collective public interest becomes marginalised. As does the notion of the state as the legitimate, and necessary, instrument for defining and supporting that collective interest. This point emerges clearly from a seminal auto-critique by Robert Bates (Bates 1990), long a leading public choice commentator on Africa, where he had celebrated and promoted the 'rollback of the state' and the 'emancipation' of the African peasant. (See Bates 1981; Bienefeld 1986: Bates 1986) But, on reflection, he now acknowledged that 'public choice theory' was based on assumptions that obscure, or even obliterate, 'the most important problem of politics' which he then defines as 'the capacity of the political process to expand the scope for collective action in the public interest. (Bates 1990:x)

This is exactly right. It is high time for the policy debate to abandon this narrow, myopic and ideologically blinkered vision of politics, just as it must transcend the narrow confines of neoclassical economics. And when it does so, political scientists and economists will meet on the new methodological terrain of institutional economics, and political economy. At that point the world will have come full circle once again, only this time for good reason. Unfortunately, this will not solve the world's problems, but it will allow us to ask the right questions and to understand more clearly he interests that are embedded in various policy options and proposals.

---

circumstances) and more contested and less 'confidence inspiring,' at least to those who want to believe the simplifications that allow apparently more 'rigorous' conclusions to be reached.

[19] This is the defining assumption, though that does not mean that issues and problems raised by this assumption have not been discussed or even questioned by some of its practitioners. The point is that this is the 'point of departure' or 'the default mode' for thinking about politics and the political process when using this lens. And, as always, it is a rather crude version of this theory that finds its way into the endless policy pronouncements of the 'experts on the ground' in the developing world. See Joseph Stiglitz's brilliant discussion of the Russian tragedy, where he believes that neoliberal 'ideologues' have wreaked havoc by utterly misrepresenting and misunderstanding the critically important link between politics and economics. (Stiglitz 1998b)

The problem is, of course, that this change in analytical focus will not happen just because, or mainly because, there are good arguments and good reasons for such a change, any more than the current orthodoxy did not arise because there was strong, persuasive evidence to support it. It will happen only if the powers that define the parameters of the mainstream debate can be made to listen and to change by political pressure. And that is as much a political project, as an academic one. That is why Krugman concludes that the popularity of 'supply side economics' must be understood as a reflection of certain interests, and why Bhagwati concludes that the continuing demand for financial liberalisation must be driven by the interests of 'Wall Street-US Treasury complex.'

As Joseph Stiglitz has recently written:

> It is not uncommon to find .. that a researcher of libertarian leanings will uncover evidence that large governments are bad for growth. As long as there is uncertainty, and there will always be uncertainty, it will be impossible to fully separate values from purely scientific discussions. Once we accept this conclusion, we realize that in giving advice we are not just purveying economic science. This requires us to think seriously about how we give advice and what incentives shape the advice we give. (Stiglitz 1998c: 3)

But as we consider the problem of engaging in the political process that shapes these policy debates, and as Cuba contemplates the challenge of restructuring its state, it is important to understand clearly what we know, and to distinguish that from the many ideological claims that are just deduced from neoclassical theory and should, therefore, carry no weight in policy debates about the real world. Those should be rooted in the kind of historical, comparative, institutional, empirical evidence that is at the centre of institutional economics or political economy. And that evidence tells a very different story. A story that is not compatible with the orthodox advice; a story that reminds us that true development has been rare and when it has occurred it has occurred in countries where states have been able to play leading, active and strategic roles in development.[20] And, although the World Bank partly acknowledges this fact in its infamous "Miracle Report" (World Bank 1993) it hastens to add that this cannot be seen as a lesson for other developing countries because they do not have the domestic conditions that are needed to make this possible, and because such interventionist policies can no longer be used because the international system of rules and institutions has made them effectively illegal. (World Bank 1993:xx)

To this one might reply that since the neoliberal model has nowhere come close to emulating the performance of those economies, especially in their capacity to remain competitive while raising domestic real wages dramatically over a long period, the conclusion should be that it is time to return to the beginning – and understand that the capacity of states to act in this developmental way has to be built, and supported, not declared impossible and illegal.

Recently the World Bank created quite a stir when its 1997 World Development Report announced that the attack on the state might have gone too far by now and that it was important to recognise that states did have a very important role to play in the economy. And many observers were led to think that the Bank had finally changed its position on this critically important question. However, a careful reading of this report shows that this was not so. In fact, the Bank was simply rewording its argument and justifying its existing policies in different words. Now the argument was that states are potentially very important economic actors, as the evidence clearly shows. Evidence

[20] For a brilliant summary of the extensive debate about East Asia which is where this battle was fought for many years, see Singh 1995. See also Bienefeld 1988; Lall 1994; Stiglitz 1998a; Wade 1990.

which the Bank had long misrepresented or denied. But, given the low 'capabilities' of the states in the developing world, this insight does not change the fact that the down-sizing of those states has to continue, in order to bring their responsibilities into line with their limited capabilities. And only later, when development and growth have strengthened those state capabilities, might it be wise for them to take over a wider range of functions. (World Bank 1997)

Unfortunately, as so often before, this deceptively plausible argument is based on a 'fast shuffle' that most readers appear to have missed. The logic of the argument rests critically on the assumption that these 'pared down, minimalist states,' thrown into direct competition with the 'big players' in the international economy, will grow and prosper and that this will, moreover, take a form in which the capabilities of their states will be systematically strengthened. It would be wise to be skeptical of such claims, which are reminiscent of certain versions of the old modernisation theory which had always promised that international economic integration would foster 'modernity' and all the good things that went with it.

There are other possibilities. Thus, such states might find after a time, that, although they had experienced some growth, they had effectively lost control of their resources, their economy and their policy process, because powerful foreign actors had come to play a dominant role in their unstable, impoverished societies. And, in that context, their state's capacity might not be strengthened and, even if it was, it might not be able to exercise those capacities in the national interest.

Interpreting Current advice on the Restructuring of States

This paper cannot discuss the various specific pieces of advice that make up the orthodox recipe for 'restructuring the state.' It will merely make two points that should be borne in mind when individual pieces of advice are examined and assessed. The first is that the individual policies cannot be designed, or assessed, except in relation to the whole. Whether decentralisation is desirable, let alone in which form it might be desirable, depends on a wide range of factors, not least the role that the state is intended to play. And the second is that the 'advice' that is so freely and so widely available needs to be assessed with care so that one can separate those claims that are based on solid historical and empirical foundations, and those that are merely ideological assertions dressed up as research findings and reflecting interests like those of Bhagwati's 'Wall Street-US Treasury complex.'

On the question of the role that the state should play I is useful to begin with the basic fact as set out by the economist Dieter Helm writing in the Oxford Review of Economic Policy that:

> Economic theory does not furnish an answer to the question as to where the economic borders of the State ought to lie. In part, this is because economic theory is an imperfect corpus of knowledge. But the major reason is that there is no 'right' answer to the question. It all depends on value-judgments. … [Moreover] .. economic theory does not provide any evidence to support a general preference *either* for markets *or* for planning … given a particular potential intervention by government, the question should be how much information do administrators and Civil servants have, how likely are they to be 'captured' by vested interests, and how good are the instruments of intervention available? Pointing out the complexity of market and government failure does not lend itself easily to simple political platforms, but it does underline the desirability of a pragmatic approach to defining the economic borders of the State. (Helm 1989:42,43)

For Cuba, coming to this question from the other side, so to speak, similar advice well taken. There is a need to be pragmatic; there is a need to be clear about the fact that the society's values should, and will (either explicitly or implicitly), set the parameters for the choices that are to be made; and there is a need to be precise about the impact of any policy choice on the subsequent dynamics of the policy process. And this is not just a matter of the potential 'capture' of certain specific regulators by those whom they are to regulate. It is also a matter of the possible 'capture' of the entire political process and of the national policy process.

Beyond this, there is a need to be concerned with way in which the broader choices that are made, define the constraints within which particular tasks then have to addressed or fulfilled by the public sector. This ultimately turns around the moral authority that a public sector is given, or that it can command, within a society. It turns around the ways in which public officials are held accountable in an inherently unstable and unpredictable world.[21] ; it turns around the way in which the rights of citizens are defined and expressed; it turns around the mix of rules, laws, moral suasion and financial incentives that one chooses to use to achieve compliance.

The close link between these framework conditions and service delivery is nicely captured in a passage from Holtham and Kay, two economists assessing the British experience in the 1990s.

> A market model based on economic individualism gives rise to a political model based on economic individualism. That model, in turn, provides public services which are of an inadequate standard, inefficiently managed, and inequitably distributed. This is, in fact, what we see in otherwise successful individualist capitalist countries such as the United States. These deficiencies form the basis of a critique of political action which is held to justify economic individualism in the first place. The paradox is that the weaknesses of state intervention to which the New Right draws attention are the result of the kind of state intervention which is the only sort possible in the society they advocate. (Holtham and Kay 1994:11)

Of course Cuba faces all of these issues in a very particular context and this paper is not about giving advice to Cuban policy makers. It is about shining a light on the international debate about state restructuring so that it can be more effectively used to inform the Cuban policy debates. And what that debate tells us, is that it is essential to be pragmatic, but that it is also important to define a broad strategy of change within individual policy problems can then be rationally addressed. This will prove a difficult task in part because deeper international integration will bring with it greater constraints on those broad strategic policy choices.

Moreover, when considering the detailed advice that is available internationally regarding such issues as civil service reform, decentralisation, privatisation, the role of civil society and NGOs, and so on, it is essential to examine the empirical, and the comparative historical evidence, on which that advice is based. And to understand that advice within the context in which it is being given, for this may alter its meaning quite considerably. To illustrate this point, I will close with an extended quotation on the 'New Social Policy' which has become so popular in the rest of Latin America as a response to the persistent problem of poverty and marginalisation on that continent.

The passage that is cited tries to show why it is so important to put such advice 'in context.' And if it is found that advice is being aggressively promoted even though there is little evidence to

[21] One of the most pernicious aspects of the neoliberal creed is the fact that it is firmly based on the notion that trust is a naïve delusion and that markets hold people effectively accountable. As a result public and private actors are held accountable in totally different ways. The tendency, at least in the industrial countries, is to hold public officials accountable to a degree, and in a manner, that is both enormously costly and ultimately paralysing, while private sector actors have much greater freedom, protected by the notion that 'the market' holds them accountable, which it does, but in an extraordinarily indirect and opaque manner.

support it, then it is necessary to examine the interests that lie behind this process and to understand their motivation – as Bhagwati has done when thinking about policy advice about capital account liberalisation. In the final analysis, one might still choose elements of this 'New Social Policy' under particular circumstances, but the choice will be better informed and more likely to succeed if it is based on a realistic understanding of what is being promoted, and why.

> The paper begins by noting that the empirical and the theoretical foundations of the claims being made on behalf of the NSP, are generally very weak. This rules out the possibility that this change is the result of a collective learning experience that has yielded a deeper understanding of the issues and allowed objectively superior social policies to be designed. And that conclusion necessarily focuses attention on the more political aspects of this policy shift, leading to a discussion of the interests that have promoted and supported it most vigorously. These turn out to be the same corporate interests, and the same international financial institutions, that are promoting neoliberal adjustment policies throughout the developing world.
>
> This conclusion serves as the point of departure for a discussion of the meaning and the significance of the NSP; a discussion that is largely concerned to determine how much of the debate surrounding this new model is best regarded as politically convenient rhetoric, and how much is really concerned with improving our capacity to alleviate the suffering of society's most vulnerable groups. Given the ambiguity of the supporting evidence, and the declared political priorities of the NSP's most ardent supporters, it is not surprising that this discussion should conclude that rhetoric undoubtedly plays a very large role. But if the widely stated concern about the urgent need to protect the vulnerable is largely rhetoric, then one must ask why these interests are supporting the NSP.
>
> Three explanations are considered, bearing in mind that these are not mutually exclusive and that each probably has some claim to a share of the truth. The first sees the NSP both as a holding action designed to create the illusion that "something is being done" and as an effective means of dividing the opposition (decentralisation, local self-reliance), opening the door further to ultimately unaccountable foreign interests (promoting NGOs) and making the victims of neoliberalism take responsibility for managing a social policy process that is most likely to fail ("empowerment"!).

For Cuba the challenge of change is especially difficult given the enormous difference between its internal social and economic structure, and those that exist in the 'world outside.' And given the overt and persistent hostility of the United States. And given the high education and high expectations of its population. And given the difficulty of reconciling expanding market activities with existing institutions, values and attitudes.

But Cuba also has many strengths. It wants change and it would probably benefit from change, but change on its own terms. Change that is introduced gradually; that builds on what exists in Cuba today; that introduces competition gradually, so that it can transform the operation of existing institutions; that mobilizes people and teaches them to understand the constraints within which policy has to be made, while at the same time making government and the policy process more responsive to their voices and their wishes.

In the final analysis, development is a collective enterprise, to a degree. And the only societies to have achieved it, have found some way of mobilising and allocating resources within a nationally defined framework. And of making policy systematically in support of this strategic vision. As I concluded in an earlier paper on the East Asian success stories:

Bibliography

Bates, Robert (1990) 'Macropolitical economy in the field of development' in J.E. Alt and K.A. Shepsle (eds) Perspectives on Positive Political Economy, (Cambridge: Cambridge UP)

Bienefeld, Manfred (1988) "The Lessons of History and the Developing World" **Monthly Review**, 41:3, July-August

Bienefeld, Manfred (1988) "The Significance of the Newly Industrialising Countries for the Development Debate", **Studies in Political Economy**, No25, Spring

Blake, Hubert (1932) **World Disorder and Reconstruction**, George Allen & Unwin: London

Caprio, Gerard and Daniela Klingebiel (1996) 'Safe and Sound Banking in Developing Countries: We're not in Kansas Any More', **Research in Financial Services: Private and Public Policy 9**, World Bank: Washington DC

Corrigan, Gerald (1993) "Challenges Facing the International Community of Bank Supervisors" in R.W. Kolb (ed) **The International Finance Reader,** Kolb Publishing: Miami

Holtham, G.H. and J.A. Kay (1994) "The Assessment: Institutions of Policy" **Oxford Review of Economic Policy**, Vol. 10, No. 3, Autumn 1994

Krugman, Paul (1999) **The Return of Depression Economics**, W.W. Norton & Co: New York

Lall, Sanjaya (1994) " 'The East Asian Miracle' Study: Does the Bell Toll for Industrial Strategy?" **World Development**, 22:4, April

List, Friedrich (1904) **The National System of Political Economy**, Longmans: London

E.J. Mishan (1982) **Introduction to Political Economy**, Hutchinson: London

Singh, Ajit (1995) "How Did East Asia Grow so Fast? Slow Progress Towards an Analytical Consensus" **UNCTAD Discussion Paper No.97**, UNCTAD: Geneva, February

Stiglitz, Joseph (1998a) 'More Instruments and Broader Goals: Moving toward the Post-Washington Consensus,' **WIDER Annual Lectures 2**, United Nations University World Institute for Development Economics Research: Helsinki

Stiglitz, Joseph (1998b) 'Whither Reform: Ten Years of the Transition' (Keynote address) **Proceedings of the World Bank Annual Conference on Development Economics 1998**, World Bank: Washington D.C.

Stiglitz, Joseph (1998c) "Knowledge for Development: Economic Science, Economic Policy and Economic Advice" Address to the World Bank's 10th Annual Bank Conference on Development Economics, ***http://www.worldbank.org/html/extdr/extme/js-abcde98/js_abcde98.htm ,*** World Bank: Washington D.C., April 20th

Tilden, Freeman (1935) **A World in Debt**, Funk and Wagnalls: New York (republished in 1983 by Friedberg Commodity Management Inc: Toronto)

Wade, Robert (1990) **Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization**, Princeton UP: Princeton N.J

Williamson, Oliver (1994) "The Institutions and Governance of Economic Development and Reform", **Proceedings of the World Bank Annual Conference on Development Economics 1994**, World Bank: Washington D.C.

World Bank (1993) **The East Asian Miracle: Economic Growth and Public Policy**, World Bank: Washington D.C.