

**COMMENTS ON**  
**“The Implications of Good Governance  
for the Reconstruction of Cuba” by Pérez**

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This paper provides the beginnings of a discussion on a topic that is both of the utmost importance and that has been somewhat neglected until recently. It should be viewed as a collection of subtopics for further discussion rather than as a definitive assessment of any particular item. With this view in mind, I offer the following three criticisms to warn about potential pitfalls in some of the arguments presented.

1. Lorenzo makes an assumption at the beginning of the discussion that, in my opinion, throws out the baby with the bathwater. Namely, he is going to discuss good governance independently of regime type. In any area where there is an interaction between good governance and regime type, this assumption makes the subsequent discussion flawed. One such area is taxation. It has been recently shown by McGuire and Olson (*Journal of Economic Literature*, 1996) that in a prototype market economy with an autocratic government the tax rate will be higher than in the same prototype market economy with a majority rule government. The level of taxation alters incentive structures in a society and good governance in terms of providing incentives will be affected by the regime type. Another such area are growth promoting policies. In a recent paper, Azariadis and Lahiri (1997) show that in a democracy where a high ability government generates higher growth by investing more in infrastructure, but requires more taxes to exist, the

voters will choose a low ability government, and implicitly the lower level of growth, at low levels of income. If good governance includes taking into account the wishes of the governed, as it should, discussions of growth promoting policies have to take into account regime type. Finally, good governance in terms of monetary policy usually includes some discussion of Central Bank independence. This concept is a bit of a contradiction in terms in an authoritarian regime. At the very least, it needs to be articulated not asserted as if it made sense, which was done in the presentation by Lorenzo as well as elsewhere at the meetings by others. In a democracy, on the other hand, it is impossible to discuss good governance in terms of monetary policy without a substantive and thorough discussion of Central Bank independence. Again the assumption that regime type does not matter flaws the subsequent discussion of good governance with respect to monetary policy.

2. The level of generality at which the topics are addressed in the paper needs to be brought down to far more concrete terms before arguments can be evaluated or suggestions become useful. I will illustrate with an aspect of the discussion of the role of government in the economic system. Government intervention is justified by the existence of market failures and some economists are characterized as extreme “minimalists” who

give little importance to these market failures. What some of these so called extremists could reply is that the same fundamental characteristics that give rise to market failures lead to government failures when governments intervene in the usual way, especially when informational problems are the source of the market failures. In the case of lending to economic agents that are small in size, for example small farmers in developing countries, it has been shown that the usual mechanisms for government intervention, such as subsidized loans to the formal economic system, make matters worse by increasing the interest rates faced by small borrowers in the informal sector due to information failures (Hoff and Stiglitz, *Journal of Development Economics*, 1996). What is needed is not a labeling of positions but an understanding of what mechanisms work under what circumstances.

3. Finally, in drawing implications for the reconstruction of Cuba it is indispensable to assess what initial conditions one is referring to in any

instance, which is not done in the paper. Again we can illustrate with an example. The most fundamental characteristic of the economic system in Cuba today, as it affects ordinary citizens, is the dollarization of the economic system started in 1993 when the dollar effectively became legal tender. Much has been made of the argument that the revolution, just like most centrally planned systems, has made criminals of every citizen by forcing them to break the law in all the ordinary transactions needed for survival. The imposition of any exchange rate system by a transition government without allowing the dollar to remain as legal tender requires making criminals again of people who have been made criminals for just about everything else over the last four years except for this activity. Good governance implies that in designing the exchange rate system this serious problem raised by the initial conditions be faced squarely in the face and addressed.