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FOREIGN INVESTMENT IN CUBA: ASSESSING THE LEGAL LANDSCAPE

Melissa JOHNS*

RESUMEN: Después de la caída del socialismo soviético y la apertura de China y Vietnam, Cuba se ha visto en la necesidad de transformar radicalmente su economía principalmente en materia de inversión extranjera. El artículo tiene por objeto analizar las posibilidades y condiciones para la realización de inversiones directas en Cuba y de los riesgos que ello implica, considerando que este país todavía se resiste a abrir completamente su economía. En la primera parte, se expone el contexto económico y político internacional en el cual se dio la transformación de la economía cubana. En la segunda parte, se explica en qué consistieron las reformas legales en materia de inversión extranjera directa. En la tercera parte, se analiza los riesgos que enfrentan los inversionistas. En la cuarta parte, se estudia el impacto que las reformas en esta materia han tenido en la sociedad. Por último, la autora realiza una comparación entre el marco legal sobre las inversiones extranjeras en Cuba y en Vietnam.

Palabras clave: inversión extranjera, liberalización económica, apertura comercial, reforma económica.

ABSTRACT: After the fall of soviet socialism and the economic liberalization of China and Vietnam, Cuba has been forced to transform in a radical way its economy, mostly in relation to the treatment given to foreign investment. The aim of this article is to analyse the possibilities and conditions of direct foreign investment in Cuba, and the risks involved, considering that there is still considerable resistance in the island to open-up the economy. In the first section of the essay, the author explains the economic and international context which has forced the transformation of Cubas economy. In the second section, she explains the most important legal reforms that have affected foreign investment in that country. Thirdly, she analyses the risks that foreign investors still have to face in the island. Fourthly, she studies the impact that legal reforms on this matter have had on the Cuban society. And finally, she compares the legal framework of foreign investment in Cuba and Vietman.

Descriptors: foreign investment, economic liberalization, trade liberalization, economic reform.

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SUMARIO: I. Introduction. II. Economic Pressures Affecting the Cuban Government. III. Legal Reform Aimed at Increasing Foreign Investment. IV. Investor Risk in Cuba. V. The Forgotten Majority: Foreign Investment's Impact on the Cuban People. VI. A Faulty Model for Cuba: the Vietnamese Transition to a Market Economy. VII. Conclusion.

I. INTRODUCTION

Cuba has undergone radical changes in its economy over the last decade. Forced to redefine its trade and capital relationships with other countries after the fall of communism in Eastern Europe and the transformations in China and Vietnam, the Castro regime has adopted a series of new laws formulated to attract foreign investment. These laws introduce market economy features to a still predominantly socialist system. The switch to capitalistic practices is not complete, however, and current political vacillations show Cuba's resistance to a full transition to an open economy. This hesitancy affects current investors, potential investors, and—perhaps most strikingly—the Cuban people, who are caught between the government's dual competing interests: economic viability and political stability.

This paper will explore Cuba's search for foreign direct investment and the risks surrounding any investment on the island. It will chart the government's stated policy and legal goals and contrast them with actual practice in the country. Section I describes the economic crises that gave rise to Cuba's opening to foreign direct investment. Section II outlines the legal reforms Cuba implemented to attract that investment. Some areas of uncertainty were not resolved by the government's reforms, however, and Section III discusses the risks investors still face. With a look to the players rarely considered in these policy changes, Section IV extends the analysis of legal reform to its impact on Cuban society. Finally, the paper briefly compares Cuba's legal framework now with pre-market conditions in Vietnam to warn potential investors

against any comparison between the two countries' paths towards market economies.

II. ECONOMIC PRESSURES AFFECTING THE CUBAN GOVERNMENT

1. The Fall of the Soviet Bloc

Fidel Castro's march into Havana on January 1, 1959, ended Batista's seven-year rule. Although Castro the revolutionary had promoted social reform during his fight for control, his campaign—called the 26th of July movement—did not explicitly embrace any political ideology before taking power besides left-of-center nationalism. There were certainly no stated plans for a complete transformation to a socialist economy. In the first three years of its rule, however, the revolutionary government replaced all of the traditional power groups in the country (the military, political parties, labor unions, and professional associations) with its Rebel Army and Committees for the Defense of the Revolution. Economic policy decisions also shifted to the Rebel Army elite, away from the wealthy Cuban families and foreign investors who had traditionally influenced policy.

The new government began to confiscate sugar lands in 1960. By the end of the year, it had nationalized all of the country's major industrial and commercial enterprises, including foreign-held centrales, oil refineries, and banks. The United States quickly ruptured relations with the island and Cuba turned east for political support.¹ By the end of 1961, Cuba-Soviet diplomatic relations had broadened and Castro dedicated the Cuban Revolution—and therefore the Cuban society it now ruled—to socialism.²

Political ties to communism extended to commercial. For the three decades leading up to the fall of the Soviet Union, Cuba depended on the USSR and communist Eastern European countries'

¹ Secretary of the Army, United States Government, Cuba: A Country Study 42 (1985) [hereinafter Cuba].

² Idem.

markets as secure buyers for its agricultural products.³ In exchange, Cuba purchased almost exclusively the goods produced in those countries. This interchange solidified into CMEA (Council for Mutual Economic Assistance),⁴ a formal trading block in which the communist nations bartered goods at prices different from those of the rest of the world.⁵

When the Soviet Union fell in 1990, followed by its satellite states in the succeeding years, it was “a big blow for Cuba”.⁶ Cuba lost 85% of its trade, 75% of its imports, and the economy declined 35% over the five years between 1988 and 1993. Along with the destruction of CMEA went Cuba’s cultivated markets, investment plans, predictable prices for imports and exports, and capital infusions for development projects to meet its infrastructure and educational means. All of this vanished almost overnight.⁷ The country entered into what the government now calls the “Special Period” where food scarcity and power outages drastically lowered the country’s standard of living. Because seventy percent of the labor force in the Cuban system is a salaried employee of the state,⁸ the people are left with few options for ensuring decent living conditions when the government faces monetary shortfalls of this magnitude.

2. The United States Embargo

One major influence on the country’s economy, however, did not change with the fall of the Soviet bloc —the United States

3 Fase Inicial del Ministerio del Comercio Exterior, Website of the Cuban Government. <http://www.cubagov.cu/des_eco/mincex/com_extP.htm> at 1. 31 de enero de 2001 [hereinafter Comercio Exterior].

4 Or CAME (Consejo de Ayuda Mutua Económica), by its Spanish name.

5 Interview with Roberto Yebra Muñoz, specialist with the Ministerio de la Inversión Extranjera, Centro de Promoción de Inversiones Extranjeras, 20 de enero de 2001 [hereinafter Muñoz].

6 Fernando Ramirez de Estenoz Barciela, Chief of the Cuban Interest Section in the United States, during a February 8, 2001 speech at Stanford University [hereinafter Ramirez].

7 Comercio Exterior, *supra* note 3, at 1.

8 León Delgado, Francisco, Foreign Investment and Labor Relations in Cuba Today: Challenges of an Upgrading Strategy at 2. Unpublished paper, Institute for European-Latin American Relations, febrero de 2001 [hereinafter Delgado].

embargo against Cuba—. The embargo is based on several major statutes: The Trading with the Enemy Act (which authorized the United States President to prohibit trade with a country during times of emergency), The Foreign Assistance Act of 1961 (which allowed the President to ban transactions specifically with Cuba); the Cuban Democracy Act of 1992 (which allowed the United States to deny foreign assistance to countries that were giving aid to Cuban, like the former Soviet states), and the Cuban Liberty and Democratic Solidarity Act of 1996 (Libertad Act), commonly known as the Helms-Burton law.⁹ These two laws from the last decade underscored the United States' traditional opposition to the Castro government.

Many aspects of the Libertad Act impact Cuba in significant ways. The Act removes the President's flexibility to individually set the parameters of the Cuban trade restrictions and returns that power to Congress, making substantial policy change much more difficult and time-consuming to achieve. Under the Act, Cuban ex-patriots in the United States received the right to bring suit in United States courts against a foreign national that "traffics" in property the Cuban exiles claim was confiscated from them by the Cuban government in the 1960s. The US court may impose civil fines up to \$50,000 against the foreign company. The fines may be seized from a company's assets if it is found that the company was operating in Cuba on this disputed land.¹⁰ The managers of those companies or individual investors in Cuban projects may also see their United States visa revoked.¹¹ Helms-Burton goes on to prohibit any indirect financing of a commercial project in Cuba by a United States citizen or entity.¹² Cuba, as well as much of the international community, fiercely protested this extraterritorial application of the United States' judicial and commercial power.¹³

9 Travieso-Diaz, Matias F., *The Laws and Legal System of a Free-Market Cuba* 14-21 (1997) [hereinafter Travieso-Diaz].

10 Cuban Liberty and Democratic Solidarity Act of 1996, Sec. 102 (d).

11 Travieso-Diaz, *supra* note 9, at 20.

12 Cuban Liberty and Democratic Solidarity Act of 1996, Sec. 103.

13 While visiting Cuba this January, I attended a mass rally in front of the United States

The full extent of the United States embargo and its regulations on Cuba, including the Libertad Act, is difficult to quantify. Capital and technology from the United States is not available to Cuban businesses. The United States consumer market, the largest in the world, is similarly off-limits. The Libertad Act pressures other countries to refrain from investing in Cuba, creating many lost opportunities if not more tangible withdrawals. The most controversial aspects of the embargo —the potential of suits in the United States courts against foreign companies investing in Cuba— have yet to be enforced. Their threat, however, certainly hangs over any proposed investment on the island. This limits Cuba's access to credit for commercial enterprises and blocks ventures into the country by potential foreign investors. Finally, the restrictions have a symbolic as well as economic impact: they signal the United State's continued denunciation of the Castro government and its intention to maintain a cold war approach to relations with Cuba.

There is also an indirect embargo that the United States maintains against Cuba. For other countries in the Caribbean and Latin America, the United States has granted direct aid, sponsored finance for development projects, and lent technical experts to train local people in social services areas. Cuba is excluded from all these programs, which include Enterprise for the Americas Initiative, Caribbean Basin Initiative, USAID programs, and the Peace Corps. Free-trade agreements have arisen between the United States and Latin American countries without mention of Cuban involvement or consultation in the policy-making.¹⁴

Some recent moves by the United States Congress signal a potential softening of its stance against Cuba. A new law went into effect in February, 2001, that allowed medical and food sales by United States suppliers to the island. Agricultural giants like Ar-

Interest Section protesting the Helms-Burton legislation. Calling it "the murderous law" (*la ley asesina*), many Cubans follow their government in blaming it for the country's poverty and poor economic outlook. Official counts placed the number attending the rally at one million persons.

¹⁴ Travieso-Díaz, *supra* note 9, at 28.

cher Daniel Midland have openly argued for a lowering of the embargo. These business interests, long-time supporters of the Republican party, may find new influence in the Bush administration.¹⁵

3. Cuba's Response to the Challenge

Forced to forge ahead alone, Cuba has had a difficult time catalyzing its economy into productive realms. Cuba owes over \$9 billion to international private lenders and has defaulted on its loan obligations. Cuba is not eligible for credit from Paris Club members and owes Russia about \$30 billion in loans it never repaid. Only Spain and France give the country export credits and because it is not a member of IMF, Cuba's ability to secure credit from the world's financial institutions is severely limited. This restricts both the number of investors that can work with Cuba on investment projects and the scope of the projects that can be undertaken.¹⁶

The economic situation on the island hit crisis level in 1994, when riots erupted in Havana. The contracting economy, rising social tensions, and increase in the number of Cubans fleeing the island in rafts bound for the United States presented Castro with his first serious popular uprising since taking power thirty years earlier.¹⁷ Responding to the threat of further instability, the Cuban government embarked on an immense process of legal and political change to encourage foreign investment. The reforms were intended to achieve the economic equivalent of a blood transfusion.

These changes bring with them significant costs to the Castro regime. Opening the country to a new private sector undermines the government's absolute control over Cuban society through job creation and wealth distribution. Some efforts have been dramatic:

¹⁵ GOP's Split over Cuba Leaves Bush on Tightrope, Chicago Tribune, Laurie Goering, 15 de febrero de 2001. <http://chicagotribune_icle/0,2669,SAV-0102150326,FF.html>.

¹⁶ Travieso-Díaz, *supra* note 9, at 110.

¹⁷ Cuba: Clearing Perilous Waters? Edward Gonzalez Rand 1996 at 23.

incentives in society moved away from seeking favor from the government to entrepreneurship as the way to improve one's life. This shift has impacted all levels of society. Even among the ruling elite, debates over the magnitude of reforms have created discord in the political debate.¹⁸

The underlying tension between economic viability and political security has influenced Castro's movements since 1994. The wide scope of the 1995 reforms in Cuban foreign investment law indicated a broad openness to capitalist money. Recent restrictions, however, show a hesitancy on the part of the Castro government to accept that money's influence on the island. The result is a constant campaign to forge a social and economic system that attracts external capital for Cuba while simultaneously protecting its internal socialist ideology. The question for potential foreign investors in Cuba becomes: when the Cuban decision-makers fall off their tightrope, will they fall to the socialist or capitalist side?

III. LEGAL REFORM AIMED AT INCREASING FOREIGN INVESTMENT

1. The Framework for Investment

Fidel Castro is a 1950 graduate of the University of Havana law school. As a young protester against the Batista government, he believed in the power of the rule of law so much that he challenged the lawfulness of the Batista rule in the Cuban courts. The courts ruled against him, stating that successful revolutions create their own legitimacy.¹⁹ Castro seems to have adopted that belief and created his own legitimacy through his own longevity in office.

So if anyone could promote an economic policy that was simultaneously socialist and capitalist, it would be Castro. His goal in managing his country's economy has not altered: to allow

¹⁸ *Ibidem*, at 25.

¹⁹ Cuba, *supra* note 1, at 36.

enough foreign investment to bolster Cuba's productivity without losing his grip on the major foundations of power-control over the people's source of money (employment) and the use of their money (commerce.) The Cuban government envisioned the road out of its desperate economic plight as paved with an infusion of foreign cash. The subsequent patchwork of decrees succeeded in encouraging foreign investors to once again become interested in Cuba, but their implementation has been less beneficial for the investor.

The Cuban government moved to open its doors to foreign investment even before the downfall of the Soviet Union and satellite states. In 1982, the Decree-Law 50 became the first Cuban law since the revolution to welcome foreign economic interests. It clearly expressed that Cuba's intention that its financial system not be isolated: "[T]he economic development of the country requires this type of [foreign] association in certain activities of the country where the financial resources, prime materials, technology and markets are not within our reach".²⁰

Even in the height of socialism, Cuba saw foreign investment as indispensable for certain sectors.

The concept of joint ventures between Cuban businesses (essentially arms of the government) and foreign persons appeared in the 1987 Civil Code for the first time in post-revolutionary Cuban law. This code broke the communist legal norm that, outside some agricultural areas and means of transportation, all businesses allowed to operate in Cuba would have to be state owned.²¹

Even with the legalization of foreign investment on the island, it was not until 1988 that the external capital began to arrive. Before then CMEA —the interchange between the USSR and Eastern Europe— prevented any investments. That system of bartering between the socialist countries set different prices than the rest of the world. Without standard prices, Cuba could not integrate its markets with other trading partners.²²

²⁰ Vega Vega, Juan, *Cuba: inversiones extranjeras a partir de 1995*, 10 (1996) [hereinafter Vega Vega].

²¹ *Ibidem*, at 29.

²² Muñoz, *supra* note 5.

Later, in 1992, the Cuban government took another positive step towards opening the country to external capital. Reforms eliminated important restrictions on foreign investment through amendments to the Cuban constitution that permitted property ownership by mixed enterprises. The amendments allowed the transfer of state property to joint ventures with foreign capital and granted foreign investors total exemption of taxes on gross income, personal income, and the transfer of real estate and business.²³ In another bold change, they allowed the repatriation of dividends, profits, and the salaries of foreign employees in hard currency to the investor's home country. The government also offered assistance in legal, economic, accounting and information services.²⁴

Constitutional reforms further modified Article 15 of the 1976 Constitution to allow the state to transfer property rights in "exceptional cases" to individuals. The language leaves open transfer to either Cuban or foreign persons. The exchange must "ha[ve] the economic objective of development for the country and... not affect the fundamental political, social, and economic policies of the State".²⁵ Because this was a significant departure from the notion that society as a whole —represented by the Castro government— owned all property, the Council of Ministers or its executive committee were required to approve each transfer.²⁶ Since the head of the Council of Ministers was Fidel Castro, the decision to privatize had to come from the top.

Thirteen years after the first foreign investment decree, the Cuban government released the Law 77 of 1995, a radical revamping of the foreign investment landscape. The law is forthright about the conditions Cuba was facing at the time:

In today's world, without the existence of the socialist camp, with a world economy that shows strong globalization and hegemonic tendencies in the political, economic, and military arenas, Cuba, in

²³ Article 23, Constitution de la Republica de Cuba (1992); Travieso-Diaz, *supra* note 9, at 106.

²⁴ Travieso-Diaz, *supra* note 9, at 106.

²⁵ Article 15, Cuban Constitution of 1976.

²⁶ Vega Vega, *supra* note 20, at 32.

the interest of preserving its victories and forced by a ferocious blockade, lacking capital, some technology, and many times market and the need to reconstruct its industry, can obtain through foreign investment, with strict respect for our independence and national sovereignty, benefits through the introduction of new and advanced technologies, the modernization of its industries, greater productive efficiency, the creation of new jobs, improvement in the quality of the products and services that it offers... that will support the efforts that an economically and socially developing country must undertake.²⁷

According to the law, all sectors of the economy are held open to foreign investment with a few exceptions for national security (no investment allowed in military operations) and traditional socialist governmental areas (no private control of community educational and health benefits).²⁸

The Executive Committee of the Council of Ministers continues to reserve final approval rights for all proposed projects. Each approval is on a case-by-case basis and is limited to a defined amount of time, determined by that committee and administered by the Ministry of Foreign Investment and Economic Cooperation (Minvec). In joint ventures, the most common time period has so far been twenty to twenty-five years.²⁹ The decisions of the two groups are not appealable.³⁰

2. Is Cuba's Plan Working?

The effects of these policy changes have been substantial. Real GDP growth in 1999 was 6.2% and it topped 5.5% last year.³¹ At the end of last year, 345 international economic ventures had formed in multiple sectors and branches. Fifty-eight more were approved this year, including projects in the energy, financial and

²⁷ Preamble to Law Number 77, Foreign Investment Act (1995).

²⁸ Vega Vega, *supra* note 20, at 41.

²⁹ *Ibidem*, at 42.

³⁰ Travieso-Diaz, *supra* note 9, at 106.

³¹ Manager's Review, Beta Gran Caribe Limited Annual Report and Accounts, 31 de marzo de 2000, at 8 [hereinafter Manager's Review].

industrial fields.³² Particularly telling is the diversity of sectors this growth represents; oil and gas have taken on new importance as exports and tourism earnings now exceed those from sugar.³³ Direct employment generation and increased productivity levels from foreign direct investment have led to 140,000 new jobs since 1995.³⁴ Although this inflow of capital still has not overcome the decrease in employment and productivity in state enterprises in the early 90s, the government clearly sees this growth as a sign that its financial difficulties are diminishing.

Among the layers of investors in Cuba are several investment companies. Convinced of the current and future profitability of economic ventures on the island, foreign businesses and individual investors have bonded together to provide funds and strategic advice for other foreigners interested in pursuing business in Cuba. These companies generally operate through a local office in Cuba staffed with Cubans and a board of directors and financial administration located outside of the country.

One prominent example of these investment companies is Beta Gran Caribe Limited (BGC). The company grants seed money to businesses hoping to invest on the island. BGC holds \$41 million in assets and seeks to increase its own capital through direct and indirect investment in Cuban businesses. The majority of these investments focus on joint ventures between foreign and Cuban companies. BGC has allocated capital to several sectors of the Cuban over the last year, including tourism, energy, and basic industry.³⁵

The 1995 foreign investment law allows actions in all sectors, but according to Felix Perez, investment manager at Beta Gran Caribe, the policies of the Cuban government more limited:

³² Marco Legal, Cuban Government website for social development. <<http://www.cuba-gov.cu/reext/colpaíses.htm>> 31 de enero de 2001.

³³ *Idem*.

³⁴ Delgado, *supra* note 8, at 3.

³⁵ Investment Progress, Beta Gran Caribe Limited Annual Report and Accounts, 31 de marzo de 2000, at 9; interview with Felix Perez, Investment Manager, in BGC's Havana office, 17 de enero de 2001.

The government wants investment in the areas in which it cannot operate effectively itself—where it needs capital, technology, and markets. Some examples of this are the petroleum sector, sugar refining, electricity generation, and tourism.³⁶

This trifocal emphasis is nowhere in the law, but it is a widely understood practice among those who invest on the island. The government embraces projects that meet its concerns and it facilitates the process for that investment.³⁷ For example, Cuba recently brought its tariff structure into line with the United States' most-favored nation norm.³⁸ The result has been sharp rises in telecommunications investment (US\$650 million since 1990), mining (\$350 million), and tourism (\$200 million).³⁹

When asked why foreign companies would be interested in investing in Cuba as compared to the many other countries with fewer political uncertainties, Perez focuses on the Cuban people. "The people are well-educated and smart. There are lots of engineers. They want to work, get ahead, and earn more".⁴⁰ In fact, Cuba has worked for decades to ensure this. Worker and human resource investment in education and health care surpasses that of most other underdeveloped countries.⁴¹ The Cuban government has reported a 98% literacy rate steadily over the last two decades.⁴² Most standard measurements of health (infant mortality, life expectancy) show Cuba is among the healthiest countries in Latin America.⁴³ Some investors go so far as to call it "the poorest first-world country".⁴⁴ The result is well-educated, sophisticated workers

³⁶ *Idem.*

³⁷ *Idem.*

³⁸ Organización del Comercio Exterior, Comercio Exterior, website of the Cuban Government, http://www.cubagov.cu/des_eco/mincex/com.

³⁹ Foreign Investment and Cuba, US-Cuba Trade and Economic Council, Inc. <<http://www.cubatrade.org>>, 20 de marzo de 2001.

⁴⁰ *Idem.*

⁴¹ Delgado, *supra* note 8, at 2.

⁴² Cuba, *supra* note 1, at XXII.

⁴³ *Idem.*

⁴⁴ Rosenau, Paul, Ekistics Architecture firm, Vancouver, Canada, 7 de febrero de 2001. Rosenau runs a casa particular in Havana with his wife, a Havana native, and represents European commercial investors in Cuba [hereinafter Rosenau].

seeking to improve their living situation. This, Perez claims, creates very favorable conditions for employers.

Nevertheless, other United States observers feel the political and economic uncertainties that surround every foreign investment transaction in Cuba make the country “high-risk”.⁴⁵ Problems of infrastructure and lack of supplies challenge tourism investors that are trying to ensure a pleasurable stay for high-end consumers. Other analysts are even more direct. As one oil company analyst in the United States asked, “Who is interested in a country without investment and contract law? Marxists are not high on property rights”.⁴⁶

IV. INVESTOR RISK IN CUBA

1. Political Risk

“Foreigners have all the rights here in Cuba”.⁴⁷ “We want more foreign investment”.⁴⁸ “Cuban policy realities are, as always, complex”.⁴⁹ Beta Gran Caribe’s chairman Peter Scott chose these words to characterize the Cuban attitude towards foreign investment. In BGC’s 2000 annual report, Scott exposed the potential negative side of Cuba’s recent economic success: it may lead to less government goodwill towards foreign investment, not more. The same factors that precipitated an opening of Cuba’s resources in 1995 —economic growth rate and amount of operational capital— may produce a gradual closing now that the government’s sense of panic has worn off.

Investors dread incremental policy changes that will eat into their bottom line as well as massive policy shifts. “Investors fear that as soon as their businesses start to make money, the govern-

⁴⁵ Travieso-Diaz, *supra* note 9, at 3.

⁴⁶ “Petrobras’ Talk of Cuban Oil Stirs Interest, but a Number of Big ‘Ifs’ Remain in Equation”, *The Oil Daily*, 8 de enero de 2001.

⁴⁷ Ferrina, Ivan, casa particular owner in Havana, 17 de enero de 2001.

⁴⁸ Ramirez, *supra* note 6.

⁴⁹ Chairman’s Statement; Beta Gran Caribe Limited Annual Report and Accounts, 31 de marzo de 2000, at 5.

ment will change the rules”.⁵⁰ Businesses in Eastern European former-socialist countries saw that frustrating but predictable phenomenon occur. When power is centralized in the hands of one person or one group with similar philosophical or economical beliefs, as in Cuba, changes can come about quickly and with little notice. Businesses that have invested on the island may lose everything in a few quick decrees.

Recent policy vacillations in Cuba are perhaps even more troubling because they are governed by a force less predictable than greed. Late in 1999, the country’s central bank refused to grant a local representative office license to BGC’s finance company, Caribbean Finance Corporation: “Although officials emphasized that they had no criticisms of CFC, the decision had some unavoidably adverse short-term consequences, creating uncertainty and disrupting operations”.⁵¹

CFC consequently hit difficult financial times and was forced to institute a general bad debt provision. “There is no economic model in Cuba” a dissident Cuban economist states. “They used to say it was socialist, but it’s really not now. But it’s not capitalist. It’s like a laboratory test tube. They pour things in, and see what happens”.⁵²

In an attempt to mitigate the risk of damaging changes in policy, foreign investors often choose a partner that the government cannot afford to anger. For example, one large joint venture fell apart a month before the planned signing because Tabacalera, the Spanish company that exports tobacco from Cuba, sold off its real estate arm. The German company that had planned to partner with the real estate company in another deal lost its protective giant, Tabacalera, through the sale. Rather than face an unpredictable Cuban bureaucracy without a strong partner to protect it, the foreign investor decided to call off the deal.⁵³

⁵⁰ Rosenau, *supra* note 44.

⁵¹ *Idem*.

⁵² Roque, Marta Beatriz, quoted in “Cuba Climbs Economic Ladder: Lack of Investment, Extensive Food Imports Slow Reform”, Karen de Young, *Washington Post*, lunes 24 de julio de 2000; A20 [hereinafter *Economic Ladder*].

⁵³ Rosenau, *supra* note 44.

2. Legal Uncertainty

Cuban officials assure foreign investors that courts will support their actions in the country. Article 5 of the 1995 Law protects foreign investors from unfair treatment in Cuban courts. "Foreign investments will be equally protected against third party claims" as Cuban companies.⁵⁴ Although no conflicts have gone to the courts since the passage of the 1995 law, cases could be received in any of the national courts.⁵⁵ If anything, says Felix Perez of BGC, the courts favor the foreigner in disputes with Cubans. He says the Court of Reclamation is available for any contractual disputes and it can be trusted to be more protective of the foreign business than the Cuban.

There is a marked distance, however, between commerce and the judicial system in Cuba. Perez characterizes the Cuban approach to commercial dispute resolution as preferring that the businesses reach an agreement on their own. He fears that courts could even impede business movement if the subject of dispute were very complicated.

Perez is not alone in his opinion. Political and business solutions, not judicial, govern the dispute resolution process in Cuba. Roberto Muñoz from the Ministry of Foreign Investment alluded to this during an interview in January 2001: "It would be very difficult for there to be any real problem between the investor and its Cuban partners. There are many steps that an investor has to go through before getting involved in Cuba. This process allows them to avoid many problems".

Other investors confirm this impression. Any foreign business investing in Cuba works primarily with Cuban holding companies created to be partners in joint ventures with foreign capital. Cimex is the largest and most powerful of these holding companies with annual revenues of about \$700 million. It operates dozens of companies and joint ventures. Cimex and the other entities borrow on the international financial markets for their own account, un-

⁵⁴ Vega Vega, *supra* note 20, at 56.

⁵⁵ Muñoz, *supra* note 5.

dergo audits, and have only one shareholder: the Cuban government.⁵⁶ Real estate investors also work closely with the planning department of each region of development.

In Cuba, the foreign business in a dispute with its partner is always opposing an arm of the Cuban government. The foreign sponsor typically resorts to Minvec (the Ministry of Foreign Investment and Economic Cooperation) to resolve the dispute. For example, a disagreement may arise between Cimex and the foreign investor on the value of a piece of land. Any land purchased is valued by an independent agency that, in fact, is still part of the Cuban government. If still displeased with the actions (or lack thereof) of Minvec, foreign investors may finally resort to conversations with Carlos Laje. Mr. Laje is in charge of economic well-being for the country and is considered to be the number three person in the Castro regime.⁵⁷ One difficulty with this mode of negotiation over litigation, however, is the imbalance of power. The defendant in the dispute in a way is the judge, as well.

Even if the courts were to be relied upon to solve disputes arising between foreign investors and their counterparts, the legal infrastructure is not expansive nor sophisticated enough to handle a large load of commercial issues. On the highest level, Cuba has a weak system of ministries and agencies that ultimately answer to Fidel Castro, the instigator of all major policy movement. The independent prosecutor's office is a small agency relative to other developed nations and is not accustomed to treating private citizens or businesses in ways consistent with due process.⁵⁸ The constitution defines the judiciary in Cuba as a subservient section under the executive's power and gives it little independent authority.⁵⁹ If a dispute did reach the level of a lawsuit in the Cuban courts, any action during the transition to a more open-market system would raise the risk of foreign investors meeting inexpe-

⁵⁶ CubaCo Features <<http://www.cubaco.com/features.htm>>, 18 de abril de 2001.

⁵⁷ Rosenau, *supra* note 44.

⁵⁸ Travieso-Díaz, *supra* note 9, at 51.

⁵⁹ Article 122; Travieso-Díaz, *supra* note 9, at 52.

rienced judges and unambiguous political manipulation of the legal process.

Furthermore, the legal structure of commercial activities still lacks permanent laws to govern foreign investment transactions. Bankruptcy, intellectual property, tax structures and environmental regulations are all still largely shaped by a small number of top government officials.

3. State-Control over Labor for Foreign Companies

The Cuban government retains control over the workers hired for jobs in foreign companies.⁶⁰ The company submits a list of the positions it will need to fill to the Center for Labor Relations, a governmental agency that then selects the person for the job. Salaries are paid through the Center to the worker in pesos and, since 1995, partially in “convertible” pesos pegged to the dollar. The state keeps a substantial proportion of the salary but covers benefits such as social security and access to health care.⁶¹ The company may pay supplemental wages to the worker in convertible pesos for “food costs”.⁶² Workers in the foreign capital joint venture’s are the most privileged segment of the labor force in terms of labor conditions and income.

If the foreign business wishes to fire a worker, it must give a “reasonable” reason to the center. The business can then suggest who should replace the worker, but the Center will only take that into consideration for its final decision. Ultimately, the government retains control over who receives what job in Cuba and uses this leverage to squelch political dissent. Besides the obvious impact on Cubans’ political freedom, this systems means that for the investors, the high quality of human resources in Cuba is not completely accessible.

⁶⁰ Article 2.j. of the 1995 Foreign Investment Law.

⁶¹ Delgado, *supra* note 8, at 5.

⁶² Interview with Juan Mercy, export officer with a Spanish mining company, 25 de enero de 2001, Havana [hereinafter Mercy]. “The government requests a “voluntary” contribution of this additional pay to the hospitals and other social programs. According to government reports, everyone participates”, Granma, 25 de enero de 2001, p. 1.

To combat some of the uncertainty created by the Cuban control of labor for foreign firms, scholars offer two options for labor reform: moderate-progression towards a more open system or fundamental changes. The moderate-progressive model would adopt general rules for labor relations to replace the case-by-case analysis currently used. This would add predictability and transparency for foreign employers when hiring, managing, and firing Cuban workers. It would also give them greater control over who represents their company in Cuba. This option could increase efficiency and labor productivity through a flexible, legally regulated system.⁶³

The fundamental change model for the Cuban labor market would integrate labor reform with productivity in the overall economy. Under this plan, the state would decentralize entrepreneurial and social security institutions and replace centralized income collection with a tax collection service. Freer labor markets would replace absolute government control over placement and salaries.⁶⁴

4. Expropriation Risk

A. Legal Underpinning

Article 3 of the 1995 foreign investment law contains the guarantees the Cuban government offers foreign stakeholders over their investment. But while it extends the protection of the state to foreign businesses operating on the island, Article 3 also raises the threat of governmental expropriation:

Foreign investments inside the national territory enjoy full protection and security and cannot be expropriated except in situations motivated for the public utility or social interest, as declared by the Government... [which will pay for] the previous indemnification in easily convertible currency at its commercial value, established by a mutual agreement.⁶⁵

⁶³ Delgado, *supra* note 8, at 7.

⁶⁴ *Idem.*

⁶⁵ Vega Vega, *supra* note 20, at 49. Article 3, 1995, Ley de Inversión Extranjera.

This language mirrors Article 25 of the Cuban constitution, which authorizes the expropriation of goods for the “public utility and social interest”. Professor Juan Vega Vega, a foreign investment law scholar at the University of Havana, finds this expropriation clause to be “nothing new or strange”. Rather, he argues, such a right is derived from the sovereign right of a state and exists in all world governments. Vega Vega maintains that even though it was necessary to include this protection for the Cuban government, it is Cuban policy to encourage investment and therefore foreign investors should not be concerned.⁶⁶

B. The Real Estate Example

Recent changes in the real estate policies show that Vega Vega’s message may be unsound advice. In early 2000, the Cuban government froze new joint venture projects that were building apartment homes for sale to foreigners. Although official spokespeople quickly sought to assure investors that “there has been no change in foreign investment policy”, their additional statement that “we are being more selective because the economic conditions of the country have improved” caused great consternation in Cuba’s foreign investor community.⁶⁷ The government allowed projects negotiated before the decree to continue but it cut off future opportunities for investment in that area. Reasons for the reversal cited by Cuba specialists range from rumors that government could not provide sewer and water hookups for the apartments to charges that Communist hard-liners opposed the extension of the private ownership movement.⁶⁸ Many investors interpreted the government’s actions as sending a message that although Cuba still wants investment in the country, the Castro regime will limit where and how that investment can take place.⁶⁹

⁶⁶ Vega Vega, *supra* note 20, at 50.

⁶⁷ “Cuba Tries to Reassure Property Investors: But is More Choosy Following Freeze on Joint Ventures”, *The National Post*, 18 de julio de 2000, C10.

⁶⁸ *Economic Ladder*, *supra* note 52.

⁶⁹ Rosenau, *supra* note 44.

When the Cuban government exercised its right of expropriation of foreign investments in the real estate markets, it honored the 1995 law and paid the investors for their property in convertible currency at market price. One has to wonder, though, how a fair price is arrived at in a closed market economy through a negotiation characterized by an extreme imbalance of power between players. The Cuban government ultimately decides what it will pay and the investor has little recourse on the amount. The only factor in the investor's favor is the negative impact a low purchase price would have on future investment flows. One further consideration is that even if the investor did recover its investment, the Cuban government's forced purchase of the project deprived the foreign business of any future profits the investment may have yielded.

Other investors face different restrictions in the real estate market. By the structure of the system, foreign businesses cannot invest in the beautiful homes in Havana or other residential communities. Private home exchanges for Cubans occur outside of an official open market where anyone hoping to move must go through an extremely complicated exchange. This process usually involves five or more families coordinating a simultaneous housing switch to create packages of equal value. Private lawyers negotiate the values and do the paperwork; government lawyers come to the closing to ratify the final deal. The system requires the consumer to have something in the country to exchange already; because foreigners do not have the right currency—a home—they are left out of the private real estate market.⁷⁰

5. Cuban Bureaucratic Uncertainties

For an investment project with foreign involvement, the government and the foreign investor usually create a joint venture in which the government provides the land and the foreigner contributes the capital. The relationship is structured as a 50/50 ow-

⁷⁰ *Idem.*

nership deal in which the two parties split the profits. The joint venture does not actually own the land or the buildings it creates but receives a lease (the time period of which is determined on a case-by-case basis, as discussed above) that reverts control rights to the Cuban government upon expiration.⁷¹

To Paul Rosenau, a Canadian architect who runs a casa particular in Havana with his Cuban wife and has worked with foreign investors building in Cuba, there are multiple bureaucratic risks to investing on the island. For starters, “Cuba is different every month”. Massive shifts in policy can occur with little notice and no public dialogue. There is no formalized process for zoning, prices or timelines. Inefficiencies and unexplained delays can cause the administrative process to take three times the amount of time government officials say it will to establish a joint venture. “Seven meetings turn into seven more. It becomes hard for a businessman to schedule the required time in Havana, to predict when and if the project will get off the ground”.⁷² Because the projects are approved on a case-by-case basis, there are no economies of scale benefits to repeating the paperwork process completed for previous investments.

6. Banking Difficulties

Other barriers to investment in Cuba are purely logistical. “Due to the US embargo against Cuba, investors should not use bank or custody accounts in the US or non-US branches of US banks or custodians for payments or receipts of funds or for the custody of certificates relating to the Shares or Warrants of BGC”.⁷³ Because United States law forbids any United States citizen or entity to engage in money transfers to Cuba without permission from the US Treasury Department, any foreign investing company that normally uses US banks will have to find other means for getting money into and out of the island. Such additional requirements

⁷¹ *Idem.*

⁷² *Idem.*

⁷³ *Manager's Review*, *supra* note 31.

present more than the normal hurdles for a company considering investment opportunities in Cuba.

So why do companies invest in Cuba? Some wish to get a foot in the door while waiting for more profitable times. Others wish to establish a presence before the United States lowers its embargo and the flood of Cuban exiles returns to re-establish their former lives in Cuba. For those with the stomach for the risk, however, investing in the country can be profitable. The largest foreign investor in Cuba is Spain's Altadis, which owns half of Cuba's Havanos S. A., the tobacco and cigar export marketer. Telecom Italia also has substantial investments in the country, owning 29% of the Cuban national telephone company.⁷⁴ Gambling on the fact that the Cuban economy could not function at current levels without foreign capital and expertise, these companies are betting that the government's socialist creed will not blind it to the country's economic needs.

V. THE FORGOTTEN MAJORITY: FOREIGN INVESTMENT'S IMPACT ON THE CUBAN PEOPLE

"The Castro regime has had and continues to have a dominating and compulsive impact on all aspects of the life of the Cuban population".⁷⁵ Written 39 years ago by the International Commission of Jurists, these words still hold true. In the area of foreign investment, the new laws and policies of the 1990s have had a profound impact on the Cuban people. The country now operates on two parallel economies —dollar and peso—. Jobs with foreign companies give Cubans access to the one thing that can quickly raise their standard of living: dollars. The peso salary paid by the government to its employees (the vast majority of the population) is not enough to live on. It amounts to roughly \$16-\$20/month and there is a drastic shortage of available food through the peso stores.⁷⁶ The government-subsidized rations range from 12 eggs

⁷⁴ Economic Ladder, *supra* note 52.

⁷⁵ International Commission of Jurists, *Cuba and the Rule of Law* at X (1962).

⁷⁶ During a visit to Cuba in January, 2001, I entered a peso store. Only eggs were

and six pounds of rice a month to 1 bread roll a day, about half of what is necessary.⁷⁷ But anyone with access to dollars can go to the dollar store where at least there is some food: tomato paste, pasta, coffee, tuna in a can, fruit juice, and fast-food pizzas.

The labor force therefore skews towards the dollar-earning jobs because pesos are not legally convertible into dollars. The result is that positions requiring high levels of education, like doctors and lawyers, earn more pesos as state employees but provide a lower standard of living because they do not give access to dollars. These professionals therefore earn less in real terms than a hotel maid who receives tips in dollars.⁷⁸ The labor force thus produces electrical engineers that choose to drive taxis and teachers that earn more serving drinks to tourists. Although estimates vary widely, between 30 and 60 percent of Cubans have access to some dollars through joint venture employers, money sent from abroad, or activity on the black market.⁷⁹

As discussed above, the government holds a strong grip on the actions of its people by carefully controlling what jobs are available with foreign firms and who will receive those jobs. The incentives for workers are governed less by a capitalist theory of efficiency than a totalitarian suppression of political dissent. The motivation for a Cuban to get the foreign company job is the same as in other open market capitalist systems —o gain currency to buy more goods—. To be successful in that, however, the worker does not have to produce more but has to live in line with the government's wishes. The ways for an employee to gain security in her job is not to work harder; it is to stay on the good side of the

available to buy and only if the purchaser had the proper coupon from the government's monthly rations. A blackboard on the wall showed when the next shipments could be expected: chicken-January 13; rice-January 25, etcétera.

⁷⁷ Economic Ladder, *supra* note 52.

⁷⁸ The Cuban government calls on all people receiving dollar tips to "donate" them back to the state for valiant causes like providing better hospitals. See *supra* pp. 55 y 56 and accompanying text. This effort, it claims, recovers 100% of the dollars received this way for the socialist system. Informal interviews in Havana exposed this to be misguided, at best. All Cubans with whom I spoke did "donate" some of their earnings back to the state, but the amount they claimed was only a small fraction of what they actually earned.

⁷⁹ Economic Ladder, *supra* note 52.

government. "Castro's hold on power rests on every Cuban's dependence on the state for sustenance".⁸⁰

Denied the opportunity to gain a dollar-earning position, many Cubans have opened their home to foreign travelers for lodging, with or without a license from the state. Their businesses are called *casa particulares* and are a common way for tourists to avoid expensive state-run hotels. The government has reduced the number of legally self-employed workers in Cuba from 206,000 in 1996 to less than 150,000 last year. Further cuts are possible. Cubans are allowed to run restaurants in their homes but few licenses have been extended to the owners.⁸¹

Individuals operating a *casa particular* with a license submit to frequent inspections by state officials. As a private business they must pay monthly taxes based on the number of rooms they are renting out (Havana) or the square footage of the space they are renting to tourists (Trinidad). These license fees can be significant costs to the business. They require the families to maintain steady flows of inhabitants if they are to cover the taxes, which are charged regardless of whether the space is actually filled. Many stretch the limits of their licenses to rent more space than allowed in order to ensure a profit; if caught, they may be fined thousands of dollars.⁸²

In the face of this tight state control of dollar-earning opportunities, alternative schemes arise for those that are excluded from the privileged class to help secure a supply of dollars. These "informal systems",⁸³ such as the black market or the practice of stretching legal enterprises to illegal limits, are informal mechanisms of exchange designed to circumvent central bureaucratic control. The black market has become so widespread due to Cuba's ineffectual management of the domestic economy that these

⁸⁰ Dennis Hayes, representative of Cuban-American National Association. World Affairs Council of Northern California broadcast, KQED, 16 de abril de 2001.

⁸¹ *Idem*.

⁸² Interview with Merle Espinoza, *casa particular* operator, 23 de enero de 2001 [hereinafter Espinoza].

⁸³ See Adler Lomnitz, Larissa, *Informal Exchange Networks in Formal Systems: A Theoretical Model*, *American Anthropology* V.90(10) at 42.

informal systems may now be considered socially imbedded in the Cuban way of life.

Fidel Castro is clearly not comfortable with this division in the economy. In a speech to Cuba's National Assembly in 1996, he warned that the state has "to reckon with a new social class, and the more power and influence it has, the bigger will be the challenge for the Revolution".⁸⁴ The influx of dollars is creating differences in standards of living that have not been seen since the revolution. Most analysts believe that Castro must control the circulation of hard currency in order to maintain economic and political power.⁸⁵

To combat the inequity between members of the labor force with access to dollars and those without, the government adopted certain measures to compensate for the gap in real income:

1. Overpricing in state shops that sell products in dollars or convertible pesos.
2. Systematic tax increases on urban self-employed people (like *casa particular* operators).
3. Promotion of the temporary migration of highly qualified workers (e. g. physicians) to other nations through contracts with those governments.⁸⁶

The government thus lowers the standard of living for those with dollars rather than raising the peso economy to match it.

Even with Castro's public opposition, the current dual system still demonstrates greater openness than previous policies. Before 1993, the average Cuban citizen was not allowed to possess dollars at all. "I used to have to get the tourists to go into the dollar shops to buy me a bar of soap" Merle, the owner of a small guesthouse in Trinidad, told me. "Now I can go there on my

⁸⁴ Villelabeitia, Ibon, *Dollarization Creates Haves and Have Nots in Cuba*, Associated Press, 30 de enero de 1996.

⁸⁵ Castro Confronts a Growing Threat: the Almighty Dollar, 21 de febrero de 2001, Stratfor.com. <http://www.cubapolitdaata.com/gpc/stratfor_cuba_010221.html>.

⁸⁶ Delgado, *supra* note 8, at 6.

own”.⁸⁷ Restrictions on consumption of dollar goods still exist, however: before a citizen can go to the dollar stores, she must present a letter to her neighborhood’s *Comite de Defensa de la Revolucion* (Committee for the Defense of the Revolution) from her employer stating the source of the dollars. Without that letter, the CDR will suspect the Cuban is receiving dollars from the United States or engaging in black market activity.⁸⁸

VI. A FAULTY MODEL FOR CUBA: THE VIETNAMESE TRANSITION TO A MARKET ECONOMY

Vietnam passed its first foreign investment law in 1987. In that year, it invited foreign organizations and individuals to invest capital and technology in the country to the extent that they respected the independence and sovereignty of that nation. This is a caveat that Cuba echos today.⁸⁹ Vietnam also opened up all areas of its economy to foreign capital and enumerated various forms of potential investment, including wholly owned foreign firms.⁹⁰

That may be where the similarities between Cuba and Vietnam end. “The Vietnam model will not have the same impact in Cuba”.⁹¹ Companies hoping that investing in Cuba during its transition towards a capitalist economy will be similar to investments into Vietnam are likely to be disappointed. To begin with, Cuba is product-poor; what it produces well, it also produces expensively.⁹² Vietnam has many high-quality, low cost products with which to trade. It produces rice, fruits, and coffee at competitive rates. The high production costs for Cuba’s state-run facilities push its products out of the general global price range.⁹³ Vietnam’s tran-

⁸⁷ Espinoza, *supra* note 82.

⁸⁸ Mercy, *supra* note 62.

⁸⁹ Ramirez, *supra* note 6.

⁹⁰ Vega Vega, *supra* note 20, at 13.

⁹¹ Interview with Brian Quinn, former analyst for Harvard Institute for Sustainable Development in Hanoi, 6 de febrero de 2001.

⁹² *Idem*.

⁹³ *Idem*.

sition to market principals also started earlier, with laws in 1979 that granted private property rights for agricultural plots.

The difference between Vietnam and Cuba plays most significantly when a company plans for a possible change in governmental administration. In Vietnam, if the current regime is overthrown, the capitalists who are now working in Hanoi will stay there. In Cuba, Castro's death could cause great societal upheaval. There may be a peaceful transition of power to Raul Castro, a bloody struggle for power among the communist hard-liners, or a mass reverse migration by Cuban-Americans hoping to re-establish their power on the island. While any agreements struck with a previous administration in Vietnam will probably be respected, any agreements negotiated now with the Castro regime have a significant likelihood of being abandoned by a subsequent change in government.

For all these reasons, investors cannot look to Vietnam as models for effective investment in Cuba. Cuba has created its own path towards open markets for foreign investment, one destined to present many blind curves for the outside participant.

VII. CONCLUSION

The barriers to successful ventures into Cuba are readily apparent. Political risk couples with uncertain economic conditions to make any investment there precarious. The Cuban government needs foreign investment to continue its economic growth, however, as much as the foreign investor needs the Cuban government to honor its pro-investment policies and promises. It is possible, therefore, to balance the rewards for both sides to ensure profitable ventures for all the players involved.

Finding that balance, however, is difficult. The foreign investor in Cuba faces a collage of messages: shifting alignments of beliefs, values, national goals and leadership directions. Cuba's policy vacillations reflect which interest, economic growth or political stability, holds the most influence at the moment. The Cuban people also reflect an ambivalence towards foreign investment. "Foreign

investment is good, but we must preserve our dignity as a people”,⁹⁴ a sculptor told me while selling his works in an open-air market near some hotels in Havana. That comment sounds strikingly similar to Fernando Remirez’s, Chief of the Cuban Interest Section in the United States: “We are trying to find more foreign investment because that is the way of the world. But we want that investment to come in a way that secures our independence and maintains our sovereignty. We strive to protect the dignity of our people”.⁹⁵

The challenge for foreign investors is to respect that dignity while ensuring both sides improve their bottom lines.

⁹⁴ Interview in a street market, Havana, 19 de enero de 2001.

⁹⁵ Remirez, *supra* note 6.