# FOREIGN INVESTMENT IN CUBA: THE LIMITS OF COMMERCIAL ENGAGEMENT

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Since the collapse of the Soviet Bloc, the Cuban government embarked on economic liberalization based on the adoption of capitalist mechanisms which include an opening to foreign investment. This has led to increasing claims abroad that engagement—particularly commercial engagement within the context of constructive engagement[1]—is the policy instrument that will lead to economic and political reform and the eventual collapse of Castro's regime. Engagement, in fact, is the fundamental element of the foreign policy of most countries towards Cuba. The emerging "new consensus" argues that the Communist Cuban regime will not be able to withstand the corrosive practices of liberal capitalism and, for this reason, considers the development of business ties with the current government desirable.[2]

The United States' policy towards Cuba has generally varied in approach; its importance is widely recognized given the two countries' geographic proximity and the historic significance of their relations. With some exceptions—the most notable during the Carter Administration—since the early years of the Castro government, it has been essentially founded on political isolation and a comprehensive economic embargo.[3] For this reason, since Cuba began a decisive opening to foreign capital, U.S. investors have been precluded from potential business opportunities there and Cuba has been unable to access the largest consumer market and source of capital and tourism in the hemisphere. Presently, the issue of U.S. commercial engagement with Cuba is considered settled until a transition to democracy is initiated there or further legislation dictates a change in policy. The Clinton Administration had been committed to encouraging a distinctive policy mechanism, which might be described as "focused engagement," aimed at supporting the emergence of a civil society in Cuba.[4] But after Cuba's February 1996 repression of an

1. Although the term commercial engagement generally refers to diverse international commercial and financial transactions, we will use it primarily in reference to foreign investment. The term "constructive engagement" encompasses economic engagement and is normally used within the context of a more comprehensive diplomatic and political relationship.

2. See, for example, Robert Kagan, "Is Castro Convertible? A Skeptic says No," *Standard*, Vol. 1, No. 5 (October 16, 1995).

3. The embargo was declared by President Kennedy in February 1962 as a result of Cuba's subversion of democratic nations in the hemisphere and its confiscation of $1.8 billion in U.S. properties. Formal diplomatic relations do not exist and almost all trade is banned, with exceptions for humanitarian assistance and payment to Cuba for telecommunications.

4. This policy line was codified in the 1992 Cuban Democracy Act, passed by Congress in 1992 during President Bush's tenure but also supported by then presidential candidate Bill Clinton. This law's Track II seeks to increase "people to people" contacts with looser restrictions on academic and cultural exchanges and was intended by the Clinton Administration as a tool to encourage private U.S. organizations to play a more active role in promoting a civil society in Cuba, looking to facilitate a more peaceful transition to democracy. See Richard Nuccio, "Promoting civic culture and support for the Cuban people," remarks at the conference *The United State and Civil Society in Cuba: A Discussion with the NGO Community*, Washington, D.C., December 1995. At the time, Mr. Nuccio was Special Adviser to the President on Cuba.

emerging organized peaceful opposition and its shoot down of two civilian aircraft belonging to the U.S.-based organization Brothers to the Rescue, President Clinton codified and strengthened the embargo by signing into law The Cuban Liberty and Solidarity Act (known as the Helms-Burton law after its Congressional sponsors). Although the Helms-Burton law does not seemingly affect Track II-focused engagement initiatives, these have been seriously curtailed by Cuba since March 1996. Nevertheless, the new law has elicited heated international debate, underscoring the relevance of commercial engagement as a policy prescription.

This paper explores issues related to the reform-generating capabilities of foreign investment as an instrument of commercial engagement by addressing three main themes deemed essential to developing a comprehensive understanding of this issue. The first part recounts Cuba's campaign to attract foreign capital, contrasting optimistic media reports to its generally unsuccessful results. The second part explains Cuba's disappointing performance by looking at the island's high-risk investment climate. The third part analyzes whether the current Cuban regime will be undermined by the influence of capitalist/market mechanisms of foreign investment and explores certain foreign policy implications.

The emerging conclusion is that two primary factors inhibit the workability of foreign investment as an instrument of reform in Cuba, rendering the argument for commercial engagement insupportable. First, the island's poor business prospects limit opportunities for achieving a level of foreign investment that can impact the economy and society in a meaningful way. Second, the existing joint venture framework—Cuba's *mode* of foreign investment—has been designed to secure regime survival by accessing foreign capital while suppressing the impact of socio-economic and political mechanisms. As a result, its most important reform-generating attributes are restrained and its detrimental side-effects actually hinder the eventual establishment of a stable free-market democracy.

I apologize to the readers for delivering a paper that grew far beyond its intended size as a result of my investigation. For this reason, it appears here in a shortened version, some of its sections greatly summarized.[5]

## CUBA'S DRIVE TO ATTRACT FOREIGN INVESTMENT

### Selling Cuba

With the demise of Soviet Communism, Cuba faced the loss of massive aid from the former Soviet Union. To cope with the devastating effects on its economy, beginning in 1989 the Cuban leadership took an unprecedented step. It opened the door to selective aspects of capitalism, which had been virtually eradicated and bitterly vilified since Fidel Castro declared Cuba a Marxist-Leninist Republic in 1961. Since its inception, the most decisive element of this opening has been a drive to attract foreign capital, essentially in the form of joint venture and economic cooperation agreements between state enterprises and foreign investors.[6] In the early nineties, several constitutional and legal amendments were passed and the commit-

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5. This paper is a revised and shortened version of a draft presented at the VI Annual Meeting of the Association for the Study of the Cuban Economy, Miami, August of 1996. My deepest appreciation goes to Stuart Lippe for his valuable advice and encouragement in the preparation of this edited version.

6. The foreign investment law defines three forms of foreign investment in Cuba: foreign joint ventures, international economic associations, and companies with 100 percent foreign capital. Our references to joint ventures apply generally to all three forms of investment. A joint venture is defined as "Cuban commercial company which adopts the form of a nominal share corporation, in which one or more national investors and one or more foreign investors participate." An international economic association is: "Joint action by one or more national investors and one or more foreign investors within the national territory for the production of goods, the offering of services or both for profit, in its two forms, which consist of joint ventures and international economic association contracts." See Republic of Cuba, Ministry of Foreign Investment and Economic Cooperation, *Foreign Investment Law,* La Habana: Editora Política, 1995. It appears that economic association or cooperation agreements do not imply the infusion of capital or the acquisition of capital participation by the foreign partner(s). Nevertheless, for simplicity's sake and due to the unavailability of specific data on this type of foreign investment, our references to foreign joint ventures will also include them.

ment and pace of Cuba's campaign to lure foreign investors intensified.[7] Given the less enthusiastic adoption of other measures of market-oriented reform, luring foreign capital has remained a consistent priority of the Cuban government's attempts to foster a desperately needed economic recovery.[8]

Indeed, Cuba has some unique things to offer foreign investors: neglected factories at bargain prices, investors' ability to freely repatriate profits and a potential to obtain fast and/or high returns. A highly educated workforce, desperately in need of employment, and kept under tight State control, is plentiful. In addition, according to John Kavulich, President of the U.S.-Cuba Trade and Economic Council (USCTEC),[9] and others, the Cuba of 1995 offers "the potential consumption of 11 million inhabitants, the political stability and the familiarity Cubans have with U.S. brands,"[10] "and most tantalizing of all, Americans are barred from trading there."[11] Primarily, because "the weight of geography is overwhelming," non-U.S. companies and investors are being urged to tie up as much business as they can get their hands on. "They will be first in a market, which, when the embargo goes, will become one big magnet for American tourists and American cash."[12]

Reports of foreign businessmen and business delegations visiting the island abound. Cuba has signed preferential trade and investment promotion and protection agreements with more than a dozen countries. The 1995 Havana International Trade Fair is said to have attracted 1,690 companies from 52 countries.[13] The U.S. business community has also shown interest in scouting Cuba's potential and conferences on "business opportunities in the new Cuba" have proliferated.[14] The Economist reported that from 1994 to 1996 "about 1,500 representatives of

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7. In 1992 Cuba's National Assembly passed several Constitutional amendments to modify the concept of private property, providing a legal basis for transferring state property to joint ventures with foreign partners while abolishing the state monopoly on foreign trade. In 1982, Cuba's Council of State had approved Decree Law 50 allowing foreign private investment in the form of joint ventures, but it was only when the economy tailspinned into a severe decline that the Cuban government began an increasingly aggressive campaign to attract foreign investment to the island.

8. The Cuban government has staged an energetic campaign to lure foreign investors. Foreign Minister Roberto Robaina has toured several major world cities, including New York, to court the international business community. Castro's highly publicized trip to New York in October 1995 for the 50th Anniversary of the United Nations has perhaps been the highlight of Cuba's efforts. Bolstering Castro's new image, the Rockefellers, bastion of American Capitalism, extended him a dinner invitation, which provoked strong protests, while Mortimer Zuckermann, editor of *U.S. News & World Report*, hosted a lunch for him at this Fifth Avenue apartment; the *U.S.-Cuba Trade and Economic Council* reported to the media that more than 200 influential persons wanted to meet with Castro.

9. The USCTEC's stated objective is to "provide an efficient and sustainable educational structure in which the U.S. business community may access accurate, consistent, and timely information and analysis on matters and issues of interest regarding United States-Cuba commercial, economic, and political relations." Founded in June 1994 as a non-profit organization, its tax status in the U.S. precludes advocacy. As a result, it does not take official positions vis-à-vis Cuba policies. For its part, the Cuban press has reported that Mr. Kavulich is "the main bridge between U.S. businessmen and Fidel Castro's government" and has "a special mission to open avenues, dissipate doubts, show the cracks through which to penetrate the wall of the blockade." Materials provided by the Council offer services which include "fully hosted" visits to Cuba. In July 1996 the Council had 138 members, which were said to include "some of the largest public and private corporations in the U.S. to individual entrepreneurs." Five percent of the members come from seven countries, including England, Canada and Mexico. Mr. Kavulich explains that the secrecy surrounding the Council's membership since its inception is a result of "competitive reasons." Based on telephone conversations of July 1996 with Mr. Kavulich; "Why the Council was established," *U.S.-Cuba Trade and Economic Council*; Homero Campa y Orlando Pérez, "Business are (sic) business" and "Exxon, IBM, ITT, Ford, y General Electric ya desbloquearon a Cuba," *Proceso, Semanario de Información y Análisis*, No. 959 (March 20, 1995); "John Kavulich: no me importa caminar sobre un campo minado..., *Bohemia*; *Caribbean Update*, Vol. 10, No.11 (December 1994); *Opciones, Semanario Financiero, Comercial y Turístico de Cuba,* Año 1, No. 46 (11-17 December 1994); and Michael Hayes, "New York entrepreneur offers facts, figures, on Cuban market," *Miami Today* (25 August 1995).

10. Elsy Fors, "Empresas norteamericanas negocian con Cuba," *Síntesis* (7 April 1995). Emphasis added.

11. "Heroic illusions: A Survey of Cuba" ("Cuba Survey"), *The Economist* (6 April 1996), p. 12. Emphasis added.

12. "Heroic illusions: A Survey of Cuba," p. 12.

13. *Economic Eye on Cuba* (30 October-5 November 1995).

14. Among some notable examples have been *The Economist Conferences* "Roundtables with The Government of Cuba." One of them, held in Havana in October of 1995, was co-sponsored by Sherritt and Iberia Airlines and titled "Cuba: a tiger in the making?"

American firms have made 'fact-finding' trips, often at the invitation of the Cuban government."[15] In August 1995 Cuban Ambassador to the United Nations, Bruno Rodríguez, stated that more than 100 U.S. companies had signed letters of intent with state-owned businesses in Cuba outlining areas of potential cooperation if trade relations were normalized (i.e., once, or if, the U.S. embargo is lifted).[16]

Cuba's drive to attract investors has also generated ample media attention. Reports of the island's opening to capitalism were spurred by its late 1993 economic reforms and the revised foreign investment law of September 1995. These incited increasingly optimistic accounts on Cuba's "move toward a market economy."[17] In the U.S. the thrust of most of these reports, together with many editorial pronouncements, was that the U.S. was missing out on opportunities in Cuba while others where eagerly gaining a foothold in a new market, taking advantage of the absence of U.S. competitors.[18] Specific investments received wide coverage, particularly the Canadian company Sherritt's mining investments and Cuba's first privatization—the telephone joint venture ETECSA with the Mexican Grupo Domos.[19] The most consistently cited source in many media reports is John Kavulich, the President of the aforementioned US.-Cuba Trade and Economic Council.[20] He typically accentuates the interest of the business community with statements such as: "There's no question that Cuba is the most exciting developing market in the world;"[21] and "For every day the U.S. business community is precluded from Cuba, it will take a year to catch up with overseas competitors."[22]

Cuba's professed economic potential has captured interest, yet projections of actual opportunities are widely divergent. At a June 1996 conference in New York, experts, however, agreed that in a post-U.S. embargo/free market scenario Cuba would have investment needs of up to around $14 billion.[23] But given the island's paltry economic performance, most claims tend to seem excessively optimistic. Many assessments lack an explanation on how they have been developed and most presume a series of profound changes that have not taken place—namely implementation of structural economic reform and the lifting of the U.S. embargo. In sum, analysts concur that Cuba must be rebuilt and desperately needs just about everything: telecommunications, railroads,

15. "Cuba Survey," *The Economist* (April 6, 1996), p. 15.

16. Sam Dillon, "Companies press Clinton to lift embargo on Cuba," *The New York Times* (August 25, 1995).

17. Some examples include: Howard French, "The end has begun: Even Castro sees the possibilities of enterprise in Cuba," *The New York Times* (August 8, 1993); "Still on the sidelines: Hard-line stance on Cuba may mean missed opportunities for U.S. business," *New York Newsday*, Business Section (September 18, 1994); Micheline Maynard, *USA Today* (December 27, 1994) cover story and related articles: "Cuba; open for business U.S. firms ready to tap opportunity;" "Farmers' markets are big success;" "Planning helps ease travel effort;" "Dollars reign supreme in the marketplace; Cuba scouting for investors"; and Douglas Farah, "Foreign investors finding Cuba more comfortable – with U.S. away," *The Washjington Post* (September 12, 1995).

18. See, e.g., Douglas Farah, "Foreign investors finding Cuba more comfortable"; Mireya Navarro, "Cuba passes law to attract greater foreign investment," *The New York Times* (September 6, 1995); José de Córdoba, "Cuba will allow foreigners to own 100% of firms," *The Wall Street Journal* (September 5, 1995); Jack Kelly, "Cuba's logical step looks like capitalism" (cover story) *USA Today* (March 11, 1996); and Dillon, "Companies press Clinton to lift embargo on Cuba."

19. In "Privatización a la cubana," *AmericaEconomía*, No. 86 (August 1994), especially footnote 51, p. 9.

20. Although the Council does not take official positions with respect to U.S.-Cuba relations, Mr. Kavulich has publicly stated his personal advocacy of the easing of economic restrictions on Cuba.

21. "Seeking a toehold in Cuba," *The Miami Herald* (July 23, 1995).

22. George Moffett, "Lunch with Cuba's Castro? U.S. eyes lifting sanctions," *The Christian Science Monitor* (March 10, 1995). The only member of the Council who has recently come forth publicly—Dwayne Andreas, Chairman of Archer Daniel Midland, ADM—has been frequently quoted calling for the removal of the embargo and the establishment of U.S. business in Cuba. Other prominent members of the U.S. business community publicly identified with this position are executives of *Carlson Companies* (which owns *Radisson* hotels) and *Otis* (elevator company), Lee Iaccoca, and Mortimer Zuckermann of *U.S. News and World Report.*

23. Notes taken by the author. Conference sponsored in New York by the Americas Society, the *U.S.-Cuba Business Council* and the Association for the Study of the Cuban Economy.

sewers, utilities, housing, fertilizers, agricultural machinery, elevators, food, medicine, toilet paper, McDonald's...; what no one can answer is how Cuba will generate the means to consume and make the required investments feasible. The seduction of Cuba's "great" or eventual potential for business is, thus, begging a serious examination of present conditions and actual results.

### The Results

Although reports coming from Cuba have pervasive discrepancies, for some investors the lure of getting to Cuba first has been tempting and often appears to have been profitable. Companies from Spain, Canada, Mexico, France, Israel, and other countries, have formed joint ventures and signed economic association agreements with the Cuban government, with a typical participation of up to 49 percent.[24] In August 1996 Vice President of the Council of State Carlos Lage, considered as Cuba's "economic czar," was cited as stating that 43 countries are present in 34 economic sectors, with most ventures operating in the areas of tourism and export-oriented products: 28 in mining, 25 in petroleum, 56 in the general industrial sector and 34 in tourism.[25] Some foreign capital enterprises provide supplies of goods and services to other joint ventures.

The tourist sector has proven what is perhaps the most visible aspect of Cuba's push to attract foreign capital—both in terms of a growing number of tourist visits to Cuba each year and probably also in terms of investment. Since 1990 the number of visitors to Cuba—primarily from Canada, Spain, Italy, Germany, and France—has reportedly increased by 54 percent, and earnings by 75 percent;[26] from January through June of 1996 visitors were said to have risen 46 percent in comparison to 1995.[27] Although projections are showing 2.5 million tourists by the year 2,000,[28] exultant reports have often been subsequently tempered by reality.[29] Statistics on Cuban tourists and earnings from tourism from the USCTEC are given in Table 1.

**Table 1. Number of Tourists and Earnings from Tourism, 1990-95**

| Year | No. of tourists | % change | Earnings US millions | % change |
|---|---|---|---|---|
| 1990 | 340,300 | | $ 242.3 | |
| 1991 | 424,400 | 19.8% | 387.4 | 37.4% |
| 1992 | 460,600 | 7.8% | 567.0 | 31.6% |
| 1993 | 546,000 | 15.6% | 720.0 | 21.2% |
| 1994 | 617,000 | 11.5% | 850.0 | 15.3% |
| 1995 | 745,000 | 17.2% | 1,000.0 | 15.0% |

**Source:** *U.S.*- Cuba Trade and Economic Council, Inc., *Economic Eye on Cuba* (1-7 July 1996).

Conflictive information on tourism investment is common. Despite reports of numerous hotel joint ventures, particularly with Spaniards and Canadians, it is impossible to determine how much represents actual capital inflow, i.e., direct foreign investment. Importantly, joint ventures in hotels "tend to be management contracts: the foreign partner will put

24. The Cuban government tends to be the majority shareholder, but there are exceptions. The 1995 Foreign Investment Law contemplates companies comprised with 100 percent foreign capital. Most analysts, however, think this will be authorized in very exceptional cases.

25. Cited in *Negocios en Cuba*, Suplemento del Mundo en Síntesis (19-25 August 1996), p.1.

26. "Cuba Report/Lage…," *The Cuba Report* (August 1996), p. 4. Between 1993 and 1995 tourism in the Caribbean is said to have grown 6.8 percent per annum, while in Cuba growth reached 17 percent.

27. It should, however, be noted that Cuba's tourist season peaks in the first half of each year and it's not clear whether the comparison is made with the same period last year or with the entire year 1995.

28. "Country Report / Lage...," p. 4.

29. For example, Cuba's Deputy Minister of Tourism expressed disappointment with a 15 percent increase in tourism revenues in 1994, short of a projected 30 percent. See Michael Becker, "Tourism misses its goal," *CubaNews*, Vol. 3, No. 2 (February 1995), p. 8. Actually the 15 percent growth rate reported by the Minister is higher than the 11.5 percent growth rate reported by other sources. Also, at least partly as a result of a migration crisis, 1995 was noted to be a "very bad, difficult year" and with the exception of Canada, the number of tourists into Cuba to have been on the decline. In fact, Minister Lage later reported that the first half of 1995 showed no growth compared to the first half of 1994. See "Country Report / Lage...," p.4.

in people and know-how, but hold back the capital."[30] Cuba's Deputy Minister of Tourism reported in late 1995 that "no significant new investments" in the tourist sector had been undertaken for a substantial time period and all the reported new deals were allegedly management arrangements rather than direct or new foreign investment. In July of 1996 this Minister said that the tourism sector had 13 joint ventures covering 8,905 hotel rooms valued at US$728 million.[31] Because the details of this valuation were not offered and the amount is almost as much as Cuba's reported "committed/delivered" figures for total foreign investment as of mid-1996 (see Table 2), direct investment in tourism would have to be lower. Plus, the recent codification of the U.S. embargo in the Helms-Burton law has dampened expectations that its impending lifting would open Cuba to the U.S. tourist market. It could already be affecting realized investment in the tourist sector, as on-going projects based on prospective U.S. tourists are probably being reassessed. The Cuban government, however, continues to claim that more growth is expected in tourist sector investments and from March through May of 1996, immediately after the passage of the Helms-Burton law, the Ministry of Tourism reported four new joint ventures and eight economic associations.[32]

As with the tourist sector, it has been impossible to arrive at actual figures for overall materialized and direct foreign investment in Cuba.[33] This appears to be clouded by smoke screens and manipulated to fit "agendas." The numbers frequently cited both by academics and in the media are those provided by Cuban government officials in speech engagements and interviews, which are then picked up by the media and Cuba-specialized newsletters and reports. In September 1996 Business Tips on Cuba cites Minister of the Economy and Planning, José Luis Rodríguez, informing of 230 joint ventures involving 2,100 million dollars—the same amount of investment cited by Minister of Foreign Investment Ernesto Meléndez one year earlier.[34] Contradictions abound, reports fail to provide data on direct foreign investment, and a distinction is not made between joint ventures and cooperation agreements.[35]

Perhaps the most telling figures are those provided by USCTEC, which has the official collaboration of

30. "Cuba Survey," *The Economist*, p. 13.

31. USCTEC, *Economic Eye on Cuba* (1-7 July 1996), p.2. Reportedly, there are 26,000 hotel rooms in the island, "but many do not yet meet international standards."

32. USCTEC, *Economic Eye on Cuba* (24-30 June 1996), p. 3. On July 1, 1996, for example, Canada's Wilton Properties Ltd. formed a joint venture with Cuba's Gran Caribe Tourism Corporation (VANCUBA Holding, S.A.), to purportedly build 11 hotels with 4,200 rooms during the next ten years. The investment calls for both partners to divide the US$400 million cost of the plan. See USCTEC, *Economic Eye on Cuba*, USCTEC, 1 to 7 July, 1996, p.2.)

33. In July of 1996 the author requested in writing and twice by telephone to the Cuban Mission to the United Nations data on foreign investment and/or a meeting with Cuban specialists in this area. Requests went unanswered.

34. *Business Tips on Cuba,* Vol. 3, No. 9 (September 1996), p. 4. *Business Tips on Cuba*, a monthly magazine which promotes business in Cuba, is a project of the *United Nations Program for Development.* It appears in seven languages and is distributed worldwide in more than 40 countries. In the United States the *U.S.-Cuba Trade and Economic Council* is its official distributor.

35. Examples of confusing and contradictory information include: 1) a report by Cuba's Ministry of Economy and Planning for the first semester of 1996 informing that a "total of 240 association agreements have been signed with foreign capital from 43 nations in 34 areas of the economy, while other 143 projects are under negotiation*."* See, *Cuba: Economic Report, First Semester 1996*, Ministry of Economy and Planning. This report also cites an unemployment rate of 8 percent, "virtually unchanged from 1995," a figure that most analysts consider absurdly low, virtually impossible; 2) the September 1995 issue of the publication *Business Tips on Cuba* stated that Minister of Foreign Investment and Economic Collaboration, Ernesto Meléndez, has reported in May of that year that 212 *economic associations* with firms from 53 countries "have brought in a capital contribution of 2,100 million dollars, which represents a 78 percent growth in relation to the same period of 1994." This $2.1 billion is the same figure reported one year later; 3) in November 1995 Minister Carlos Lage and the *Comisión de Estudios de la Economía Cubana* provided the following information: whereas in 1993 there were 173 joint ventures from 36 countries, by late November 1995 there were 270 from 50 countries. See Magdalys Rodríguez, "Trabas al empresario interesado," *El Nuevo Día* (23 November 1995) and *Negocios en Cuba*, Suplemento del Mundo en Síntesis (19-25 August 1996), p.1.

### Table 2. Foreign Investment in Cuba, as of August 1, 1996 (in U.S. dollars)

The following figures represent the amounts of announced, committed, and delivered investments since 1990 by private sector companies and government companies from various countries to enterprises within the Republic of Cuba as of 1 August 1996. Information was compiled through the media, other public sources, individual discussions with company representatives, non-Republic of Cuba government officials, and Republic of Cuba-based enterprise managers and government officials:

| Country | Announced | Committed/delivered |
|---|---|---|
| Australia | 500,000,000 | — |
| Austria | 500,000 | 100,000 |
| Brazil | 150,000,000 | 20,000,000 |
| Canada | 41,000,000 | 100,000,000 |
| Chile | 69,000,000 | 30,000,000 |
| China | 10,000,000 | 5,000,000 |
| Dominican Republic | 5,000,000 | 1,000,000 |
| France | 15,000,000 | 10,000,000 |
| Germany | 10,000,000 | 2,000,000 |
| Greece | 2,000,000 | 500,000 |
| Honduras | 7,000,000 | 1,000,000 |
| Israel | 22,000,000 | 7,000,000 |
| Italy | 97,000,000 | 87,000,000 |
| Jamaica | 2,000,000 | 1,000,000 |
| Japan | 2,000,000 | 500,000 |
| Mexico | 2,256,000,000 | 250,000,000 |
| The Netherlands | 300,000,000 | 40,000,000 |
| Panama | 2,000,000 | 500,000 |
| Russia | 25,000,000 | 2,000,000 |
| South Africa | 400,000,000 | 15,000,000 |
| Spain | 350,000,000 | 125,000,000 |
| Sweden | 10,000,000 | 1,000,000 |
| United Kingdom | 75,000,000 | 50,000,000 |
| Uruguay | 500,000 | 300,000 |
| Venezuela | 50,000,000 | 3,000,000 |
| TOTAL | 5,301,000,000 | 751,900,000 |

**Source:** *U.S.- Cuba Trade and Economic Council,* September 28, 1996.

Cuban government entities and representatives. Although contradicting and vague reports have also come from the Council,[36] in mid-July 1996, its President provided the author an updated table (Table 2) on foreign investment in Cuba: $5.3 billion "announced" and $751.9 million "committed/delivered." It should be noted that the USCTEC table does not furnish an explanation of the meaning of "announced" or of "committed/delivered" investment.[37]

Cuba's accounting practices—its reporting of foreign investment and other national accounts, including GDP—do not follow the standards of most countries.[38] The discrepancy in the foreign investment figures provided by the Cuban government is further enhanced by conflicting information obtained elsewhere. Jorge Pérez-López[39]explains:

- The United Nations Conference on Trade and Development, a United Nations organization of which Cuba is an active participant, shows foreign direct investment into Cuba of $1 million in 1990, $10 million in 1991, $13 million in 1992, $21 million in 1993, and $15 million in 1994. It reports cumulative foreign direct investment of $1 million in 1985, $3 million in 1990, $25 million in 1993, and $40 million in 1994.
- Balance of payments data in a 1995 Banco Nacional de Cuba report show foreign direct investment inflows of 54 million pesos in 1993 (US$540,000) and 563 million pesos in 1994 (US$11 million).

36. In 1995 Council materials were reporting more than 200 joint ventures valued at US$1.5 billion and total announced investment of US$4 billion. ("Realities of Market Cuba," *U.S.-Cuba Trade and Economic Council,* not dated.) On the other hand, *The Washington Post* quoted Mr. Kavulich stating that by August 1995 there were US$4.9 billion in announced foreign investments, of which $556 million had been formally committed. See Douglas Farah, "Foreign investors finding Cuba more comfortable." Notice that the terminology "formally committed" is vague; by the choice of lexicon it does not appear to mean "actually invested."

37. In a telephone conversation of September 10, 1996 Mr. Kavulich explained that they did not have a figure for materialized direct investment. In July he had indicated that after the passage of the Helms-Burton law, the data on foreign investment would now tend to be politically sensitive, as this posed risks to investors.

38. As per reports of many Cuba analysts, including José Alonso, Research Specialist at the U.S Information Agency's (U.S.I.A.) Radio Martí.

39. Jorge Pérez-López, "Foreign direct investment in the Cuban economy: A critical look," paper for delivery at *Foreign investment in Cuba: past, present, and future*, Workshop sponsored by Shaw, Pittman, Potts & Trowbridge and Oceana Publications, Washington, D.C., January 26, 1996, pp. 9-10.

- A 1994 government of Spain report on Spanish overseas investment cites Cuba as a recipient of $50 million since 1988 and $117 million committed through the year 2000. Furthermore in November of 1995 a high government official of the Spanish government informed the Spanish Congress that Spanish enterprises had invested $28 million (3,350 pesetas) since 1990, mostly in services and tourism,[40] although it has been often said that Spanish investments in Cuba are one of the highest.

In sum, "the Cuban figures do not correspond to the International Monetary Fund's measurement norms and definitions of direct foreign investment."[41] Contrary to standard practice in the calculation of direct foreign investment, the data provided by Cuban sources, in addition to direct capital inflows, appears to include the following: 1) foreign contribution of assets or debt-equity swaps;[42] 2) supplier credits, and other financial agreements; 3) foreign participation in management contracts or production partnership arrangements, defined as international economic association contracts, which are subject to uncertain valuations; 4) "announced" investments which may be contingent on events that do not materialize; 5) in mining investments, exploitation contracts to service or expand deposits already mined (i.e. the component of fresh capital investment is limited); and 6) canceled deals.[43]

The latter is of particular relevance because some of the most publicized investments in Cuba have eventually failed but may still be included in the government's reports. For example, two very large "announced" Mexican investments have fallen through. In September of 1995 Mexican Foreign Minister José Angel Gurría confirmed "the suspension" of a $200 million investment by Mexpetrol and provided no explanation.[44] The Grupo Domos investment was reported to have floundered even before the crisis that led to the passage of the Helms-Burton law by the United States.[45] Another investment gone sour has proven particularly embarrassing for the Cuban

40. José Luis Dehesa, Spain's Secretary of State for International and Iberoamerican Cooperation, as cited in Pérez-López, "Foreign direct investment...," p. 9-10.

41. Armando M. Lago, "An economic evaluation of the foreign investment law of Cuba," 1995.

42. Only two debt-equity swaps have been completed under exceptional circumstances. Both were between Mexico and Cuba and were largely dependent on intergovernmental accord. Cuba's debt situation must be resolved before a debt-conversion program can be established. See *The Cuba Report*, Vol. 5, No. 2, (June 1996), p. 5.

43. Information provided by José Alonso and in J. Pérez-López, "Foreign direct investment..., p.10.

44. This consortium of Mexican state and private companies had planned to run a Soviet-built refinery at Cienfuegos, in Cuba's southern coast. Apparently no U.S. properties were involved in the project, so the threat of U.S. sanctions was not considered the cause for the suspension. *Reuters Wire Service* (September 22, 1995).

45. Domos is, on paper, Cuba's "largest joint venture," and was reported to have failed to make a $320 million payment which was due in October 1995 for its share in ETECSA, the telecommunications joint venture with Cuba's Emtel. Apparently, the company had not been successful in its efforts to 'dump' 24 percent of its share of ETECSA. Domos admitted to be on the lookout for a partner to contribute the needed infusion of capital, which it acknowledged not having, in order to proceed with the announced investment project of $750 million. Its President, Javier Garza, explained that the financial difficulties had arisen after the Mexican government refused a loan it was to extend as part of a $300 million debt equity swap agreement. In June 1994, Mexican Grupo Domos, a Monterrey-based family enterprise focused on real estate development and waste management, was reported to have invested US $200 million and promised to invest $500 million in coming years to obtain 49 percent of Cuba's Empresa de Telecomunicaciones de Cuba (ETECSA). At the time of the announcement Domos was said to have used its initial $200 million to buy $300 in face value Cuban debt from the Mexican National Development Bank. As part of the deal, the Development Bank was also to grant Cuba a $300 million credit line for purchases from Mexico during 1995. Former Mexican President Carlos Salinas De Gortari was reported to have helped put the deal together and flew to Havana to celebrate the signing of the agreement. Subsequently Domos was said to have sold 12-25 percent of ECTESA, allegedly for US$291.2 million, to the Dutch wholly-owned subsidiary of the Italian state telephone company, STET. Emtel is reported to operate with the assets of a subsidiary of ITT, which has a $131 million dollar claim against the Cuban government for its confiscated properties. See L. Crawford and P. Fletcher, "Estocada al programa de privatización de Cuba," *El Nuevo Día* (20 de febrero de 1996); *Cuba Bulletin*, U.S. Cuba Business Council, No. 30 (March 29, 1996), p. 6; Kerry Dolan, "Their man in Havana," *Forbes* (September 11, 1995), pp. 60-66; "Privatización a la cubana," *AmericaEconomia*, no. 86 (August 1994); "Scion of a powerful Mexican family jumps into the big time," *Global Finance* (July 1994); J. Pérez-López, *Odd Couples: Joint ventures between foreign capitalists and Cuban socialists,* University of Miami, The North South Agenda Papers, Number Sixteen (November 1995), p. 24; and Larry Press, "Cuban Telecommunications Infrastructure and Investment," in this volume.

government. In May of 1995 the Cuban government canceled its contracts with the Spanish company Endesa's pension fund, which had been managing several hotels in Cuba.[46] There are still other cases of announced investments not materialized or gone sour.[47]

Given the absence of solid data on direct, materialized, and net foreign investment (which is typically available for most countries), in order to strike some comparisons we must use Cuba's figures for "committed/delivered" investment in relation to net direct foreign investment in other developing countries (Table 3). Keeping in mind that the number we have for Cuba is higher than materialized net investment, a brief sample of some developing countries can put even this inflated figure into context.[48] Out of the 19 countries examined, only one—Bulgaria—reported a lower figure than Cuba's "committed/delivered." Moreover, Cuba pales painfully in comparison with the two countries in Latin America that have similar populations, Ecuador and Chile. In a similar 5-year period, Ecuador had around 2.5 times more net foreign investment and Chile more than 7 times that of Cuba's "committed/delivered" foreign investment. To submit foreign investment in Cuba to an even more poignant contrast, between 1990-95 materialized foreign investment from just one South American country in another—Chilean investment in Argentina—was 69 percent higher than incoming investment from the whole world reported by Cuba.[49]

**Table 3. Net Foreign Investment in Selected Developing Countries, 1990-95 (in million U.S. dollars)**

| | | | |
|---|---|---|---|
| **Latin America** | | | |
| Mexico | 31,015 | Chile | 5,498 |
| Argentina | 19,259 | Venezuela | 4,762 |
| Brazil | 13,376 | Peru | 4,567 |
| Colombia | 6,562 | Ecuador | 1,913 |
| **Rest of the world** | | | |
| Malaysia | 26,867 | Greece | 6,042 |
| Indonesia | 12,965 | South Korea | 5,047 |
| Portugal | 11,503 | Turkey | 4,354 |
| Thailand | 10,104 | Philippines | 3,765 |
| Poland | 8,073 | Morocco | 2,414 |
| Bulgaria | 391 | | |

**Source:** J.P. Morgan (July 1996).

Despite the secrecy and contradictions surrounding Cuba's foreign investment, it is clear that results are not to the government's liking. Regarding the level of foreign investment, in mid-1995 Fidel Castro declared: "It's small, too small." He added that he's had to waste his time in meetings with "idiots and swindlers" who come to Cuba "with false offers and documents, and all sort of meaningless proposals."[50] The March 1996 passage of the Helms-Burton law by the United States is expected to chill investment further,

46. Thomas Vogel, "Havana headaches," *The Wall Street Journal* (August 25, 1995).

47. For example, at the end of 1994, Total, the French oil company, had withdrawn from offshore oil explorations which resulted in two dry holes. In 1990, Total had signed a production partnership agreement by which the French company was to supply capital, specialized equipment, technology, and personnel for oil exploration activities; production was to be shared with the Cuban *Unión del Petróleo*. *See* Pérez-López, *Odd couples...*", p. 9. A well-publicized Spanish hotel investment fell apart—the original partner for the Meliá Cohiba hotel dropped out, leaving the government to complete construction on its own. See Teo A. Babun, "Cuba's investment boom that never was, " *The Wall Street Journal* (March 1, 1996).

48. A net investment figure assumes that Cuban capital is not being invested abroad, which would not be the case if illegal outflows are taking place, and excludes revenue or dividend repatriation on realized foreign investment. The numbers provided for other developing countries are for net foreign investment, which accounts for capital outflows; the materialized gross investment in these countries should actually be higher.

49. Materialized investment by Chile in Argentina for 1990-95 totaled $2.416 billion dollars, while the total for committed investment was $5.916 billion. As for trade, Chile's imports for one month are almost equal to Cuba's for the entire year. See *El Mercurio*, Santiago (February 10, 1996). Total Chilean investment overseas *just in the first semester of 1996* amounted to US$464 million, 62 percent of Cuba's total accumulated "committed/delivered" foreign investment through August 1, 1996. Moreover, materialized foreign investment totaling US$1.03 billion in 1995 and US$1.985 billion in just the first six months of 1996 flowed into Chile. See *El Mercurio*, Santiago (August 9, 1996 and July 24, 1996).

50. Quoted in J. de Córdoba, "Burocracia dificulta apertura de Cuba," *The Wall Street Journal Americas* (October 10, 1995).

although Cuba's drive to attract foreign capital by all counts already appeared generally unsuccessful.

## PROBLEMS AND RISKS FOR FOREIGN INVESTORS

In light of Cuba's economic and political scenario, it is perplexing to see frequent reports of business opportunities which downplay and oftentimes almost completely disregard the high risks of investing in Cuba.[51] However, more sophisticated risk reports—such as annual rankings in Euromoney and Institutional Investor—systematically classify Cuba as one of the riskiest countries in the world to do business.[52]

Scouting opportunities and actually making them happen are two very different things. For example, in 1993 Creditfinance Securities Inc., a Canadian investment firm opened an office in Havana, looking to be part of the "avalanche" of expected investment into Cuba. After analyzing many projects during two years of negotiations with the Cuban government, it retreated, alleging too many obstacles to completing transactions. A lack of cooperation and constant changes in the investment policy were cited. The Catalan group Guitart, which took options in a large number of hotels, also withdrew from Cuba due to the island's "increasingly frustrating" political climate.[53]

The gap can be wide between potential investors' high expectations and the actual result of due diligence analyses. Vietnam, for example, has a population of approximately 73 million, almost seven times that of Cuba, and has implemented an economic liberalization program which, in depth, consistency and duration, is far-reaching in comparison to Cuba's.[54] (In fact, advocates of engagement with Cuba use Vietnam as an example to be followed.) Despite sustained economic growth as a result of consistent market-oriented reforms, by 1995 media reports began surfacing of businessmen's difficulties doing business there (also commonly in the form of joint ventures): time-consuming bureaucratic procedures, difficulty in finding the right partners and following the right procedures, lack of housing and supplies, high cost of living, a primitive banking system, and poor infrastructure and communications.[55] Today the mood of investors is being described as "a far cry from the optimism of a year ago when Washington improved relations with Hanoi and investors saw Vietnam as Asia's next tiger economy, rich in natural resources, cheap labor and with a big hungry market."[56] Making matters worse, the July 1996 Vietnamese Communist Party Congress disappointed investors with its determination to pace the economic reforms and keep major industries in government hands retain control while reasserting and increasing the authority of the Party over every facet of Vietnamese life.[57]

No matter how high the adrenaline rush at the prospect of an apparently enticing new market, it is undeniable that Cuba presents a highly risky business climate for investors. Even Cuban officials recognize the limitations. Minister of Foreign Investment Octavio Castilla has stated:

> "What Havana wants to do is channel foreign investment into the manufacturing sector, as more than 80 percent of our plants are idle. But it has proven diffi-

51. For example, *Time*'s 5-page cover story of February 20, 1995, "Open for Business," has only three sentences referring to risks from 31 paragraphs devoted to business opportunities in Cuba. A 1996 5-page *Foreign Affairs* article by scholar Pamela Falk on the issue of business in Cuba mentions the word *risk* only once and only in the following context: "Meanwhile, the pace for non-U.S. foreign investment in Cuba quickens, despite the country's political risks." See Pamela Falk, "Eyes on Cuba: U.S. business and the embargo," *Foreign Affairs* (March-April 1996).

52. For example, *Euromoney*'s 1995 survey of 181 countries ranked Cuba behind Somalia, just ahead of Haiti. See "Cuba Survey," *The Economist*, p. 12.

53. Babún, "Cuba's investment boom that never was."

54. Carlos Quijano, "A comparison of Cuba and Vietnam," presentation at the V *Annual Meeting of the Association for the Study of the Cuban Economy,* Miami, August, 1995; and Julie M. Bunck, "Market Leninism: Vietnam and Cuba in Transition," in this volume.

55. Edward A. Gargan, "For U.S. business, a hard road to Vietnam," *The New York Times* (July 14, 1995).

56. Steth Mydans, "Tiger economy has become a fading vision for Vietnam," *The New York Times* (July 25, 1996).

57. Mydans, "Tiger economy has become a fading vision" and Bunck, "Market Leninism."

> cult. First, there is almost no one whom to sell to, the internal market is practically not existent and one cannot sell to the United States, the largest potential market, due to the commercial embargo. ...Then, there's the Cuban peso, ...not convertible, even if the government wishes it to be. On the other hand, the Cuban workforce although highly qualified, is too expensive. We cannot compete with the rest of the Caribbean."[58]

Due to the fierce global competition for a limited, albeit vast, pool of capital funds, Cuba's ability to capture capital investment should be evaluated realistically and with care. Potential investors will develop cost-benefit analyses which will assign different weight to a distinct set of factors depending on their particular industry, line of business, and the characteristics of the investment proposal. The role of specific issues—such as the inability to access the U.S. market—in the evaluation of business potential will depend on the type of project under consideration. Regardless, the overall high level of risk of investing in Cuba will affect every investment and will have to be entered into the analysis. This appears to explain why Cuba has been generally unsuccessful in attracting foreign investment, why the amounts investors are willing to gamble are low, their return/recovery requirements are very high—discouraging capitalization and re-investment—and the sectors favored for investing limit multiplier and dispersion benefits.

Following are some of the major risks and problems associated with investing in Cuba:

**1. The abject condition of the Cuban economy and its scant prospects for meaningful recovery.**[59]

The severity of Cuba's economic crisis is worth noting, given its importance in determining Cuba's potential for business. It also puts into proper context the Cuban government's acute need to attract capital, get foreign joint ventures to absorb the country's excess workforce, and bring relief to the economy.

With the fall of Communism in the Eastern Bloc, Cuba suffered a dramatic economic collapse due to the loss of Soviet subsidies and assistance.[60] As a result, by 1993 the Cuban economy had contracted by around 70 percent, experiencing a huge drop in both exports and imports; by the end of 1995 it was estimated that 80 percent of the island's productive sector was paralyzed. Topping off an already dire picture, Cuba's debt with Western financial institutions has been in default since 1986 and remains shut out of international credit markets.[61] As a result, in March 1990 a series of austerity measures were announced within the context of what was called the "Special Period in Time of Peace."

To deal with the crisis, beginning in 1989 the government started to actively seek foreign investment, initially presenting it as a temporary measure centered on developing the tourism industry. This was an important step for a country that had decried cap-

58. The Minister was quoted in de Córdoba, "Burocracia dificulta apertura de Cuba."

59. A summary of Cuba's economic condition and reform process has been left out this paper since others in this volume of ASCE's *Cuba in Transition* series cover this issue in depth. Primary sources for this section, in its full version, include: issues of *Economic Eye on Cuba*, *Cuba News, The Cuba Report, Boletín de la Asociación de Economistas Independientes de Cuba*, articles in *The Wall Street Journal* and *El Nuevo Herald, Foreign Affairs,* publications of the *U.S.-Cuba Business Council*, *Reuters Wire Service,* and papers presented at Annual Meetings of the *Association of the Study of the Cuban Economy.*

60. It has been calculated that the Castro regime received an estimated $100 to $150 billion in aid from the Soviet bloc over three decades, as well as another $1.2 billion or more a year in military assistance -more aid that the U.S. provided to the whole European continent through the Marshall Plan after World War II. In the last years of the of Soviet Communism, Cuba is said to have been receiving Soviet aid of up to $6.7 billion a year. See Adolfo Leyva, *Propaganda and reality: A look at the U.S. Embargo and Castro's Cuba* (Miami: The Endowment for Cuban American Studies of the Cuban American National Foundation, July 1994).

61. Calculations of Cuba's hard currency debt vary, but National Bank President Francisco Soberón recently put the amount at US$10 billion. See USCTEC, *Economic Eye on Cuba* (8-14 July 1996), p.1). In addition, Cuba owes $14.6 billion rubles to the former Soviet Union which is said to equal between US$20 to 25 billion, depending on the exchange rate applied, *The Cuba Report* (October 1994), p.8. Foreign Minister Robaina has explained: "Cuba simply doesn't have the money to pay," *American Banker-Bond Buyer* (October 2, 1995), cited in Gabriel Fernández, "Cuba's Hard Currency Debt," in this volume.

italism for over three decades and in actuality signaled the beginning of a series of changes. A reform process started in earnest in late 1993 with the legalization of the holding of dollars and was followed by number of measures, namely: the authorization of certain categories of self-employment, the reorganization of land usage to allow agricultural cooperatives to sell production in excess of quotas in free markets, the introduction of income taxes, the authorization of free markets for certain scarce consumer and manufactures products, and the introduction of a convertible peso. Deficit-reduction measures were also implemented.[62]

The reforms appear to have produced positive effects, although still leave much to be desired. The decline was detained in 1994, year in which a growth of 0.7 percent was reported, followed by a growth of 2.5 percent in 1995 and 9.6 percent in the first six months of 1996. But after late 1994 the pace of liberalization slowed down considerably amidst signs of the leadership's unwillingness to continue opening up the economy.[63] Additionally, despite Cuba's dire economic situation, substantial spending as a proportion of GDP continues allocated to maintaining the internal security apparatus. For the first half of 1996, Minister Lage recognized that Cuba's financial situation remained strained and reported a decrease of 7 percent in export prices together with a rise of 13 percent in import costs.[64] At the end of 1994 a desolate assessment had been delivered by two Cuba analysts: "The adopted piecemeal measures and reforms are incoherent, inconsistent, and ill-conceived in design, incomplete in scope, incorrect and delayed in execution and, consequently, inadequate in impact."[65] This has yet to be proven wrong. Presently, the reform process appears to remain stalled as structural change of any consequence seems to have been vetoed for political reasons.

Regardless of the apparent betterment of a critical situation, an economy which has suffered a decline of this magnitude would require decades to return to previous economic levels unless vigorous growth occurs. And the previous economic level left much to be desired. Before Cuba became interested in foreign investment, it had received substantial foreign capital via international bank credits and, even at the height of its advantageous economic relationship with the Soviet Union, the island suffered shortages of food, clothing, appliances, cars, manufactured goods, and many basic products. In fact, Cuba's economy during the revolutionary period has simply been incapable of producing what it needs/wants to consume.[66] The Cuban economy was able to survive an earlier collapse only thanks to massive Soviet support and, actually, defaulted on its external debt even before the cessation of Soviet assistance. The demise of Soviet aid merely made a lacking performance reach critical mass.

In light of Cuba's daunting experience and the recognized failure of socialist command economies, the obvious conclusion is that Cuba's severe economic decay is a result of the failed economic model and ineffective policies adopted by its leadership, together with severe economic mismanagement.[67] The socialist centrally-planned model has been incapable of

62. These included the reorganization of the State bureaucracy, subsidy cuts for state enterprises, price increases for certain products and public services, and cuts in subsidies for health and education.

63. During 1996 several reforms were approved which primarily resulted from previously approved measures, namely in the area of increased taxation. The most significant was the June 1996 regulation on free trade zones, offering substantial tax havens but very similar characteristics of the joint venture arrangements.

64. "Country Report/Lage...," pp. 4-5.

65. R. Castañeda and G. Montalván, "Cuba 1990-1994: Political intransigence *versus* economic reform," *Cuba in Transition—Volume 4* (Washington: Association for the Study of the Cuban Economy, 1994) p. 208.

66. Cuban economist Jorge Sanguinetty, a high official of Cuba's Planning Board until his exile in 1967, has indicated that from the very beginning of the Revolution—since 1963—the Soviet Union had to subsidize the Cuban economy.

67. The gross mishandling and irrationality of Cuba's economic management has been extensively documented starting in the early sixties with French socialist Rene Dumont's account *Cuba, est-it socialist?*

generating sustainable growth and material prosperity and has been described as inherently inefficient, characterized by fraud, corruption, theft and privilege, blocking and even penalizing of individual initiative, beset with irrational, rigid and complex regulations and norms, devoid of concepts such as self-responsibility, efficiency, and incentive, and plagued by poor organization, low productivity and inflexible centralized planning disassociated from the forces of supply and demand. As a result, Cuba's economic viability is unrealizable until profound structural changes are implemented on the economic front. This limits business opportunities significantly and affects the risk factor for investing—a situation that will continue affecting Cuba's ability to obtain badly needed foreign capital.

**2. The absence of an independent legal system and a rule of law and a weak foreign investment regime.**

The United Nations Special Rapporteur for Cuba, Carl Johan Groth,[68] has stated that Cuba's system of administering justice "is mainly at the service of the prevailing political system"[69] and has detailed many of the problems embodied in the Cuban legal system. Most international human rights organizations report similar conclusions.[70] In addition, Cuba's foreign investment regime is direly deficient in comparison to the regulatory framework of most developing countries.

The new Foreign Investment Law—No. 77 of September 5, 1995—had been long awaited by potential investors with great expectation, but mainly codified practices that had already been taking place, proving generally disappointing.[71] A renown analyst commented that the revised law "leaves a lot to be desired, since it kept intact many of the risks that were responsible for the failure of the earlier Law No. 50."[72] To compensate for the law's shortcomings, it appears that investment authorizations will continue to include enticing inducements such as expedient capital recovery, attractive pricing, tax free repatriation of revenues, tax holidays, and 100 percent repatriation of profits.

Some of the problems associated with the new foreign investment law are: [73]

*i. Restricted liquidity of investments:* The sale or transfer of investors' capital to third parties is subject to the approval of the government. Article 13.5 reads: "Once the joint venture is created, the partners cannot change except with the consent of the parties and the approval of the authority that granted the authorization." This is a critical restriction on investors' "exit strategy," which is a fundamental consideration in evaluating investments.

*ii. High risk of foreign exchange losses:* The law stipulates that the transfer abroad of net profits, dividends, proceeds from sale of capital, and the value of expropriated property are to be calculated in "freely convertible currency," a term or formula which is not defined and, thus, remains uncertain. Due to the volatility of the market conversion rate of the peso to hard currencies and because the Cuban peso is officially set at the artificial rate of one peso to the dollar,

68. This Swedish diplomat was named to monitor the human rights situation in Cuba as per the United Nation's General Assembly Resolution of March 1992. He has not been allowed entry into Cuba.

69. October 1995 Report of the United Nations Rapporteur for Cuba, p. 4.

70. Among the many described deficiencies are the subordination of the Judiciary and Attorney General to the Executive and Legislative powers, the requisite that judges and magistrates be "actively involved in the Revolution, the absence of due process and the lack of impartiality of trials. (1993 Interim Report of the United Nations Rapporteur.)

71. It did incorporate some welcome changes, namely allowing certain real estate investments in which ownership and property "rights" would be acquired and the possibility of companies with 100 percent foreign ownership.

72. Lago, "An economic evaluation of the foreign investment law of Cuba," p. 1.

73. Vogel, "Havana headaches." Because it is almost impossible to obtain a copy of a foreign joint venture agreement, we can only make general observations based on what is inferred from the Foreign Investment Law and anecdotal accounts. *The Wall Street Journal* has indicated, in reference to joint ventures: "One of the conditions of these arrangements is that you keep your mouth shut." This has also been reported by several sources to the author.

valuations are unpredictable and could be subject to political manipulations. Furthermore, since the foreign investor is not allowed to have peso deposits in foreign banks outside of Cuba, it is impossible to hedge the risk of devaluation.[74]

*iii. Risk of reversibility of investment agreements; unreliability of the government's commitment to capitalism:* Although the new law offers investors more guarantees than the previous Decree 50, it does not settle fears that joint venture agreements may be reversible. Article 3.3 of the Foreign Investment law reads: "The foreign investors within Cuban national territory enjoy full protection and security and their assets cannot be expropriated, except for reasons of the public good or in the interest of the society..." Depending on how the clause is applied, it has been noted that joint venture investment agreements could be terminated by the Cuban government essentially at will, without due process nor adequate compensation. What's worse, there is "no mention of recourse to the courts to impugn the validity of the declaration,"[75] and the law stipulates that jurisdiction for any litigation belongs to Cuban courts, which are not independent of the state. It has, however, been reported that certain investments have been or could be negotiated to override this disposition.[76]

Cuba has signed investment protection agreements with 19 countries which diminish fears of expropriations, but troubling precedents already exist.[77] But troubling reports have surfaced—two involving investments from Spain, which under the government of Socialist Felipe González had close ties with Castro: 1) hotel investments entered into in 1991 by the Spanish utility company Endesa's pension fund were unilaterally canceled by the Cuban government in May 1995;[78] and 2) in 1992 Castro decreed the nationalization a Spaniard's 49 percent participation in the Comodoro discotheque, unilaterally fixing the amount of economic compensation. Finally, amidst a climate of concern, Cuban government officials for the first time admitted to have canceled the licenses of "dozens" of foreign firms operating in Cuba since 1992 because of "corrupt practices."[79]

Cuba's foreign investment system forces investors to accept riskier business regimes than those common to most markets by precluding the formation of cor-

74. Lago, "An economic evaluation…"

75. Alberto Luzárraga, "Castro's self-imposed embargo," *New York Law Journal* (December 20, 1995). Emphasis added.

76. Armando Lago has noted that some agreements with Spanish investors stipulate that expropriations will be resolved by arbitration in France. See Lago, "An economic evaluation …," p. 3.

77. Italy, Russia, Spain, Colombia, Great Britain, China, Ukraine, Bolivia, Vietnam, Argentina, Lebanon, South Africa, Romania, Chile, Barbados, Germany, Greece, Sweden, and Switzerland. See USCTEC, *Economic Eye on Cuba* (24-30 June 1996), p. 2.

78. Despite the existence of an investment protection agreement with Spain, the Cuban government unilaterally canceled all management contracts this investor had for several hotels in Cuba. Claiming that the Spanish side had failed to live up to its agreements and was in arrears in some contracted payments, Spanish directors were replaced by Cubans and Endesa bank accounts in Cuba were frozen. The Spanish investor—Kawama Caribbean—has taken its dispute with the Cuban government to the International Arbitration Tribunal in Paris, demanding $12 million from Cuba. It claims that it withheld payments because the Cuban partner was not fulfilling its contractual obligations. See Carlos Alberto Montaner, "The risks of investing in Castro's last hurrah," *The Wall Street Journal* (May 22, 1992.) Two other examples are: 1) In 1992 Davidoff was reported to have gone to court "to defend its rights against the unethical tactics of its Cuban partners." (See Montaner, "The risks of investing…"; and 2) In September 1995 *USA Today* published a letter from a former German investor in Cuba with an "eager warning to potential investors from the United States. Parts of the letter read: "I believed in the huge opportunities being offered by the very promising marketplace. I was proud to call among my Cuban friends high-ranking officials, famous athletes. ...all of this did not save me from being taken by four security agents to their headquarters where I was held without questioning from nine in the morning to four in the afternoon—and then put on a plane back to Germany. ...policeman stole my three vintage Harley motorcycles, antique furniture, jewels, and fax machines from my Havana apartment." See Harry Koening, *USA Today* (September 12, 1995).

79. Expressing the need for greater controls against "adventurers, fortune seekers, and troublemakers who conspire with Cubans to defraud the state," Castro himself called for the creation of a corps of 35,000 to go after them. Although this took place before the enactment of the 1995 Foreign Investment Law, it remains to be seen how the government will proceed. Christopher Marquis, "Cuba set to stop bribes, kickbacks in own ranks," *The Miami Herald* (August 18, 1995).

porate structures such as limited liability companies and general partnerships. Among its peculiarities, it institutionalizes concessions for foreigners not generally available to residents of Cuba and requires investors to participate in joint ventures which subject workers to government control and wage confiscation.[80] These business associations could be readily disallowed by a future government of Cuba, which could declare their expropriation, and even the payment of back wages to workers which have been subject to wage confiscation.[81]

Furthermore, the government's erratic commitment to capitalism and foreign investment is cause for concern. Apprehension is fueled by repeated statements against capitalism, continued expressions of commitment to Marxist-Leninism, and the slow pace of reform. While the text of the foreign investment law is free of the typical ideological language of most Cuban laws and regulations, the National Assembly passed an accompanying statement stressing that Cuba's economic opening "is not inspired by neo-liberalism nor does it aim for a transition to capitalism. It is an opening to defend and develop socialism and this is not concealed by our government and is present in the spirit of this law."[82] It is also possible that the government could grow comfortable with the economic improvement. Analysts have pointed to previous successful reforms which were subsequently reversed, demonstrating what appears to be a pattern of implementing reforms until the results they produce create ideological contradictions deemed intolerable by the leadership.

Foreigners have also expressed concern over Law 149, passed in May 1994, which applies retroactively against "excess profits," albeit one normally applied to Cubans. The law has been severely applied, especially against the new Cuban capitalists – macetas— and successful private restaurants and taxi services. Foreign investors observe with anxiety that the government considers making money a crime.

*iv. Inability to hire workers directly:* The Cuban government insists that "those who work for foreign capitalists must continue to feel that they owe loyalty and gratitude to the state."[83] Thus, the new law preserves the Cuban state's identity as sole employer by keeping provisions of the former law which prevent Cuban workers from being hired directly by foreign companies, except in authorized "exceptional cases."[84]

Under the foreign joint venture arrangements, the Cuban government "provides" the workforce through a special employment agency of the government (empleadora nacional).[85] It receives payment in hard currency from the joint enterprise, but remunerates the workers in salaries denominated in Cuban pesos at a minimal fraction of the amount received. Allegedly, wages are fixed at equivalent amounts to what workers in state enterprises are earning for the same or similar jobs.[86] In the tourist sector, a portion

80. Due to, among others, the exclusion of the Cuban population from investing in joint ventures or any type of company Canadian Professor Archibald Ritter has remarked: "Still it's socialism for the Cubans and capitalism for foreigners..." de Córdoba, "Burocracia dificulta..." Cuban exiles, however, can invest, a provision probably fashioned after the Chinese experience with the intent of luring the exile community. China has been successful in attracting substantial capital infusions from the Chinese expatriate community.

81. This amount could be subtracted from the compensation due to expropriated joint ventures.

82. Babún, "Cuba's investment boom."

83. "Cuba Survey," *The Economist*, p. 12.

84. The only known exception to this rule is incorporated in the June 1996 regulation of Free Trade Zones, which authorizes direct employment except in enterprises with 100 percent foreign ownership. Its effect is yet to be seen. *The Cuba Report*, Vol. 5, No. 2 (June 1996), p. 6.

85. The Foreign Investment Law defines the employing entities as: "Cuban organizations with legal status, authorized to establish a contract with a joint venture or a totally foreign capital company, through which it supplies, at the company's request, the workers of various skills needed by the company, who are employed by that organization." Republic of Cuba, *Foreign Investment Law.*

86. Marta Beatriz Roque, President of the *Instituto Cubano de Economistas Independientes* explained that the government applies a wage scale which calls for increases as the worker successfully performs in three different stages of approximately two years, each subject to evaluation, with wages reaching a ceiling. In telephone conversation with the author from Havana, August 21, 1996.

of the tips must also be turned over to the Cuban management. Aside from the negative effects this has on the investors' international image, other practical disadvantages arise from this arrangement.

The salary fixed by the Cuban State is not competitive with the rest of the Caribbean and Central America on the basis of labor costs (Table 4). Joint ventures are said to be paying the state around between US$400 and 500 per month per worker.[87] If we use, for example, hourly wages for garment workers as a rough indication, Cuba's workforce is much more expensive, especially when a series of additional benefits are added to basic wages to give workers some incentives. One investor reports: "You can pay $500 for an employee, and he only gets the equivalent of $20. I know they need more than that to live on, and if they don't get it, they steal or simply not work. So we take measures."[88] These—bonuses, gifts, meals, automobiles, hard currency under the table—increase the cost of labor, which already, in the words of this investor, "does not come cheap." Theft is a huge problem,[89] and providing workers with transportation, uniforms and other requirements of their job brings the tab up, all to the detriment of profitability. Meanwhile, the competition to attract investors among countries offering cheap labor is steep. "Worldwide the number of workers in 'export processing zones' has risen from 50,000 in 1970 to more than 4 million today." In the Caribbean, the Dominican Republic alone has 27 free trade zones.[90]

If international pressure on Cuba to cease the wage confiscation scheme was to strengthen, the government would be hard pressed to lower the share of wages it retains or abolish wage retention altogether. Nevertheless, by eliminating the State's most important source of earnings from foreign joint ventures, the current cost-benefit equation for both the government and foreign investors would be considerably distorted; its underlying rationale could even become obsolete.[91] This would likely diminish, if not altogether eliminate, investors' appetite for investing. Hence, it is not likely that significant improvement will be seen in this area.

Another irritating problem for foreign investors is associated with hiring practices in joint ventures. The government employment agency selects employees by screening their "Labor Record" (expediente laboral) and "Cumulative School Record" (expediente acumulativo escolar), which systematically gather personal information to assess revolutionary commitment. Ideas and behavior deemed contrary to official ideology limit access to academic and work centers. Because hiring is also subject to cronyism, the foreign-capital enterprise's access to workers on the basis of merit may be restricted, as the most capable and experienced workers may be banned for political reasons or patronage may be dictating who gets hired.[92]

On the other hand, foreign investors may regard with convenience certain aspects of the State's "control" over the workers. *The Economist* has noted that because Cuba's foreign investment regime is based on establishing joint ventures with the Cuban state, the partnership makes it "easy to hire, fire, and control workers" and "comes in handy in dealing with the

87. Cuban economist Marta Beatriz Roque pins the average at US$450.

88. Douglas Farah, "Foreign investors finding Cuba more comfortable – with U.S. away," *The Washington Post* (September 12, 1995).

89. In one big hotel "the entire kitchen staff had to be sacked for thieving. The 'missing' figures for towels and sheets, passes by chambermaids to their friends at the back door, can only be guessed at." See "Cuba Survey," *The Economist.*

90. Steve Chambers, "Low wages tempt U.S firms to Dominican free trade zones," *The Star Ledger* (March 17, 1996).

91. The opportunity cost of allowing foreign investment would increase for the government, already concerned with its inherent dangers. A reduction in incentives for the government would mean that the risk premium for investing in Cuba would go up. Or, in order to compensate for the loss of earnings from wage retention, the government would seek returns through other mechanisms, which under the current scheme may be working as incentives to investors. This would increase costs and/or or decrease advantages for investors.

92. Joint ventures, however, are said to have some level of flexibility in pressing for certain individuals and the law allows foreign enterprises to request the replacement of workers in cases in which the worker "does not meet the requirements of the job."

**Table 4. Monthly Salary of Garment Workers, 1993 (in million U.S. dollars)**

| | |
|---|---|
| Honduras | $100.80 |
| Dominican Republic | 110.88 |
| El Salvador | 120.96 |
| Guatemala | 127.68 |
| Jamaica | 131.04 |
| Costa Rica | 176.40 |

**Note:** Wages paid by foreign joint ventures in Cuba to the state employment agencies are said to range between US$400-500 per month.

**Source:** This calculation is based on hourly wages, multiplied by 40 hours per week and 4.2 weeks per month, relying on data from the National Cotton Council, the U.S. Department of Commerce, Textile Highlights, the U.S. Department of Labor, and the International Labor Organization, as reported in *The Star Ledger* (March 17, 1996).

bureaucracy."[93] The Cuban government declares that the current labor system is "far more convenient" for foreign investors. Importantly, the special labor regime in the international tourist sector—enforced since 1990 and expanded constitutionally in 1992—restricts the rights of these workers more than in other sectors, allowing foreign investors greater flexibility.[94] Workers in this sector are subject to longer probationary periods and work hours, more irregular schedules, shorter periods for challenging disciplinary decisions, and no right of appeal through usual judicial and administrative channels. In addition, there is a prohibition against conducts that "might tarnish the exemplary moral and social image" such as criticizing the national tourism enterprise or any government agency in the presence of tourists.[95] Raúl Taladrid, Deputy Minister for Foreign Investment and Economic Development, told *The Wall Street Journal:* "we are free from labor conflict; nowhere in the world could you get this tranquillity."[96]

*v. Potential claims on confiscated land and properties and the threat of U.S. sanctions:* Foreign and native interests lay claim on land and properties confiscated by the revolutionary government which are being made available for business transactions with foreign investors. Because Cuba's violation of international law on this count is virtually undisputed, litigation in national and international courts could continue for decades. Claims of Cuban citizens alone are estimated at around US$7 billion.[97]

The governments of Switzerland, France, United Kingdom, Italy, Canada, and Mexico have negotiated compensation agreements for nationalized properties. The percentage of settlement payout is said to be very low despite the generally small amounts of property confiscated from these countries.[98] United States citizens, however, are particularly affected by this issue; from May 1959 to October 1960 the Castro government seized assets of U.S. citizens and companies in what is "the largest confiscation without com-

93. "Cuba Survey," *The Economist*, p. 13.

94. Article 141 of the Cuban Constitution of 1976 requires that a referendum be held to ratify any amendments. This provision was ignored. See Rolando Castañeda and George Plinio Montalván, "The Arcos Principles," *Cuba in Transition—Volume 4* (Washington: Association for the Study of the Cuban Economy, 1994), p. 365.

95. Castañeda and Montalván, "The Arcos Principles," p. 366.

96. Vogel, "Havana headaches." The President of the Cuban Chamber of Commerce, Carlos Martínez, has also explained: "...due to the characteristics of the Cuban labor market, the fact that a Cuban businessman takes care of labor aspects gives the foreign investor guarantees that any problems of litigation will be handled by the Cuban partner. ...The foreign businessman does not know the labor market. The Cuban partner selects the best employee. The companies in Cuba are satisfied." Rodríguez, "Trabas al empresario interesado."

97. Pérez-López, "Foreign direct investment in the Cuban economy," p. 20 cites Dick Kirschten, "Raising Cain," *National Journal*, 27:26 (1 July 1995), p. 1714), who has stated these claims are estimated to exceed U.S. claims by a factor of four.

98. *The Cuba Report* (August 1996), p. 5. Historically, post-confiscation settlement ratios have varied significantly but tend to be low. Restitution and compensation schemes have also varied widely, particularly in the recent East European experience. Vietnam is an atypical case; it is said to have compensated the U.S. 100 percent of capital for confiscated properties. See "Resolution of Property Claims in Cuba's Transition," Transcript of Proceedings, Cuba Transition Workshop, Shaw, Pittman, Potts & Trowbridge, Washington, D.C., January 26, 1995.

pensation of U.S. properties by a foreign government in the history of the United States."[99] Since 1991 U.S. embassies all over the world have on several occasions warned their host governments that their investors may face legal complications if they invest in confiscated U.S. properties in Cuba. In fact, two certified U.S. claimants—Procter & Gamble and Consolidated Development Corporation—have recently challenged two joint ventures in Cuba outside of the Helms-Burton's law right of action.[100]

The March 1996 enactment of the Helms-Burton Law by the United States further complicates the issue of claims. Its Title III seeks to protect the property rights of U.S. nationals and corporations by giving U.S. citizens which hold valid claims a right of action to U.S. courts against those who knowingly traffic in their confiscated properties.[101] Its Title IV declares the exclusion of "traffickers" and their immediate families from entry into the U.S. Although both provisions are being denounced and contested as extraterritorial in certain international frameworks—some countries threatening or passing countermeasures—it seems doubtful that they can be unilaterally overridden.[102] But even before its enactment, despite what at the time was considered the unlikelihood of its passage with sections penalizing foreign "traffickers," just the threat of Helms-Burton had an effect.[103] After its passage, foreign investors are said to be "privately and through a series of offshore corporations effectuating their investments in Cuba."[104] But it appears that the law has indeed discouraged investment. Acting U.S. Assistant Secretary for Inter-American Affairs, Jeffrey Davidow, reported to Congress in July 1996 that as a result of enforcement of Title IV of the Helms-Burton Act "a significant number of companies with possible involvement in confiscated U.S. properties have informed the State Department that they are disengaging from those activities."[105] Several firms, including Cemex of Mexico, the South African mining company Gencor and American Express, are said to be reconsidering or to

99. "Questions and Answers about U.S. Claims Against Cuba," *Joint Committee on Cuban Claims*, 1977. The *Joint Committee on Cuban Claims* is a voluntary organization composed of U.S. stockholders and companies. Registered claims with the U.S. government total $1,851,358.00 (5911 claims from individuals and corporations), amounting to over $5.2 billion at the end of 1993. Interest is accrued at a 6 percent annual rate. As per the principle of diplomatic protection, these claims were assumed by the U.S. and are administered under the Foreign Claims Commission's Cuba Claims Program, authorized by U.S. Public Law. See *Cuba News,* Vol.1, No. 4 (December 1993), p.8.

100. Procter & Gamble has challenged a joint venture created between Unilever and the Cuban enterprise Suchel for using its confiscated plants. See Pérez-López, "Foreign direct investment...," p. 20. On July 2, 1996, Consolidated Development Corporation, filed a suit in a U.S. District Court against Sherritt Inc. and the Cuban government, demanding a jury trial and seeks compensatory damages in excess of $1 million in addition to punitive damages, interest, and legal fees. See *U.S.-Cuba Policy Report*, Vol. 3, No. 7 (July 29, 1996). Legal difficulties for these complaints to succeed have been reported as significant, allegedly in light of several previous failed attempts to have U.S. courts seek remedies. *The Cuba Report*, Vol. 5, No. 3 (July 1996), p. 3.

101. This is intended to provide a legal vehicle to claim restitution from those investors in Cuba who also hold assets in the United States.

102. Jennifer Hillman, General Counsel of the U.S. Trade Representative, declared at a July 1996 Congressional hearing that the Administration considers the law "fully consistent with U.S. international obligations, and in particular with our commitments under the NAFTA and the various trade agreements overseen by the WTO." *The Cuba Report* (August 1996), p. 6. Title III has been suspended by Presidential waiver incorporated in the law, pending consultations with allies to build support for the promotion of democracy in Cuba. The law, however, was allowed by President Clinton to "come into force." The first nine "letters of determination" have been sent to Sherritt and Grupo Domos directors and officers warning of 45 days to divest of operations in Cuba before their names are entered into visa lookout systems for their exclusion from U.S. territory. *U.S. Cuba-Policy Report*, Vol. 3, No. 7 (July 29, 1996).

103. It was reported to have derailed important investment plans by companies such as BHP, a giant Australian mining company that sells expertise, equipment and supplies to Cuban nickel operations. Despite a rise in worldwide nickel prices, BHP was allegedly concerned that its investments would make use of plants confiscated from the U.S.; given its steel and coal mining interests in the U.S., it feared retaliation. See Ana Radelat, "Cuba's appeal as investment is cooling off," *The Miami Herald* (June 23, 1995).

104. Radelat, "Cuba's appeal as investment is cooling off," p. 3.

105. *The Cuba Report* (August 1996), p. 2.

have put the brakes on investing in Cuba.[106] Grupo Domos, whose telecommunications joint venture ETECSA is subject to claims by ITT, is apparently having trouble syndicating a 25 percent portion of its share.[107] Canadian financial institutions with significant assets in the U.S. are said to be extremely sensitive to the legislation.[108] Reports of stricter due diligence by investors have been received, in many cases with demands that the Cuban government certify that the targeted investment is clear of U.S. claims.[109] Cuban Minister Carlos Lage has acknowledged that Cuba's chances of attracting investment have been reduced,[110] declaring that the law will have to be "abrogated, frozen or broken."[111]

*vi. Administrative and infrastructure constraints affecting profitability and efficiency:* Many investors complain about the myriad distortions of efficient economic behavior ingrained in every aspect of Cuba's socialist system. Compounding the absence of such concepts as self-responsibility and managerial efficiency, excessive, irrational, rigid, and complex norms and regulations for every activity.[112] A number of problems have been reported which impose frequent and sometimes serious disruptions, restrict the efficiency of operations, increase costs, and lower profitability:

- poor management, auditing, and accounting practices by the Cuban partner;
- constant interference by Cuban officials ignorant of the norms of the market;
- inability of the Cuban economy to supply inputs[113]or a chronic lack of organization on the part of the existing domestic supplying enterprises;
- restrictions on selling to the local market;[114]
- the chaotic state of Cuba's infrastructure: electricity blackouts, power shortages and poor public services – water, sewage, etc.;
- a poor telecommunications infrastructure, lagging behind most of the world;[115]
- extremely deficient public transportation, hindering workers' ability to get to work;
- unavailability of domestic credit.

*vii. Uncertainty and hassles surrounding the approval process of foreign investment projects:* Aside from restricting investments in several sectors, including sugar production, the law specifically calls for many investment proposals to be subject to case-by-case

106. Cemex, the world's fourth largest cement producer terminated its contracts in Cuba; Gencor dropped plans for an operation in Pinar del Río; and American Express severed business links to Cuba. In addition, Occidental Hotels canceled contracts valued at US$900,000 per year to manage four Varadero hotels, Grupo Vitro, a Mexican bottling company canceled plans said to include property confiscated from Owens-Illinois, and two Dutch firms ceased trade with Cuba. See *U.S-Cuba Policy Report, Vol. 3,* No. 6 (June 28, 1996); *The Cuba Report* (August 1996), p.2 and (June 1996), p. 3; and *U.S.-Cuba Business Council.*

107. *The Cuba Report* (June 1996), p. 8.

108. *The Cuba Report* (July 1996), p. 7.

109. See for example, "First Canadian JV...., *The Cuba Report* (August 1996), p. 3.

110. "Admite Lage efectos de la ley," *Diario Las Américas* (9 de agosto de 1996).

111. *Negocios en Cuba*, op.cit., p. 1.

112. Castañeda and Montalván, "Cuba 1990-1994," p. 192.

113. This is particularly costly for the tourist industry, where common supply shortages, especially of food, drive up costs and hinder efficiency, affecting profitability. Hotels report 50-60 percent of their supplies as imports, while overall estimates of the imported component of the tourism product—ranging from furniture, textiles, food, and electrical systems—are 45-60 percent. Pérez-López, "Foreign direct investment...," p. 12.

114. Although private retailing is not allowed, the June 1996 Free Trade Zone regulations authorize businesses to export 25 percent of production to Cuban national territory, which will be levied with normal import tariffs, with reductions depending on input content. José Alonso, "Foreign Trade Zones in Cuba," (September 20, 1996). Foreign companies are also generally unable to compete against state enterprises offering similar goods and services in the domestic market. See Pérez-López, *Odd couples...*," p. 22.

115. See Press, "Cuban Telecommunications," for a detailed analysis of the Cuban telecommunications industry.

evaluation.[116] Most investment proposals are, therefore, subject to individual negotiation and approval by the government, allowing for much discretion and complexity. Cuban Foreign Investment Minister Octavio Castilla warned: "By having said we are interested in foreign investment does not mean anyone who comes will receive authorization to invest."[117] The bureaucratic process of approvals often involves several government agencies, complicating the negotiation of agreements and resulting in delays and higher opportunity costs/business expenses in comparison with alternatives.[118] Also, it appears to be common practice to pay bribes, wine and dine and/or give gifts to prospective Cuban partners in order to obtain lucrative contracts. If so, the legal and business risks of an accusation and the added cost of the bribes or gifts must be factored into a decision to invest.

*viii. Potential claims for environmental restitution:* Because "regime survival is linked to economic recovery,"[119] Cuba's emphasis on development over environmental protection is not surprising.[120] As a result, many measures taken during the "Special Period" are said to convey great threats to the environment. Yet, the 1995 Foreign Investment Law calls for investment to be compatible with the protection of the environment and the sustainable use of natural resources. Because Cuba's law on the environment (Law 33) is so vague and many Cuban industries being made available for joint ventures have historically been heavy polluters, "foreign investors could be forced, at the convenience of Cuban authorities, to do extensive clean-up costing millions of dollars."[121] Some environmental experts further believe the Cuban government "plans to use the environment and the Law 33 as a political tool for their convenience and their benefit."[122] Environmental damage could be used as a "legal justification" at the discretion of the Cuban authorities if a joint venture is suddenly deemed undesirable for any reason. An investment deemed to be harmful to the environment could be subject to substantial new capital requirements for remedies and/or penalties. Furthermore, a new government could penalize foreign investors by seeking environmental restitution; in fact, environmental damage could be included in a calculation of compensation payment for decreed expropriations.

### 3. Political risk: absence of stability and mounting socio-political ferment

Cuba, by all accounts, presents an unstable political climate given the totalitarian nature of its regime and the current government's eradication of a stabilizing

116. Authorization must be obtained for investment proposals over US$10 million, those involving construction or exploitation of any public service -including transportation, communications, aqueducts, and electricity, those proposing total foreign ownership, those related to the Armed Forces' commercial system, and those involving transfers of state property or a real right which is the property of the state. Furthermore, it grants the government the power to authorize "foreign investments not mentioned..." (in addition to those listed). Although the 1995 law states that the maximum period for authorization is 60 days, the enforcement of this clause is questionable at this juncture. The unavailability of information does not allow us to assess whether this provision has been complied with since its inclusion in the September 1995 law.

117. de Córdoba, "Burocracia dificulta apertura..."

118. It has, however, been noted that this also allows investors the opportunity to seek provisions which afford special benefits and protections. See "Is Cuba cooling down?" *The Cuba Report* Vol. 4, No. 5 (September 1995), p. 5 and Lago, "An economic evaluation of the foreign investment law of Cuba," p. 2.

119. David S. Collis, "Environmental implications of Cuba's economic crisis," *Georgetown Cuba Briefing Paper Series*, No. 8 (July 1995), p. 8.

120. See Sergio Díaz-Briquets and Jorge Pérez-López, "The special period and the environment," and B. Ralph Barba and Amparo Avella, "Cuba's environmental law," both in *Cuba in Transition—Volume 5* (Washington: Association for the Study of the Cuban Economy, 1995).

121. Barba and Avella, "Cuba's environmental law."

122. They cite the explanation given by Lionel Soto, President of the Cuban Council of Ministers, that Russia had a debt with Cuba of between 20 and 25 million dollars as a result of its natural resources exploitation and environmental contamination in Cuba. This is the estimated amount of Cuba's debt with Russia. See Barba and Avella, "Cuba's environmental law."

civil society. Aside from the losses that social upheaval and even civil war would represent to investors, we have noted the possibility that a future Cuban government could declare a review of the terms and conditions of joint venture agreements, even their annulment, with the potential expropriation of their assets. Two exiled Cuban economists have stated: "...the rights granted to foreigners in many of the current joint venture agreements will likely be declared null by any future government of Cuba bent on developing a competitive market-based economy."[123] The following reasons are cited: 1) inexperienced and/or corrupt government officials and managers are entering into business agreements with foreign investors; 2) information on the assets involved in negotiations is lacking; and 3) not forcing foreign investors to compete transparently and adequately is probably reducing the market value of national assets and concessions.[124] In addition, opponents of the present Cuban regime regarded it as a de facto government and challenge its legitimacy.

Investments in Cuba have limited country and political risk insurance alternatives. Because traditional export coverage is generally not available, the private insurance sector is required for most policy coverage. Political risk and country risk coverage for expropriation, confiscation, and nationalization is provided by a number of entities primarily in London and premiere pricing is said to vary substantially. [125]

### 4. Social resentment directed against foreigners

A system of economic and social apartheid linked to foreign investment and tourism is strictly enforced by the Cuban government with foreign acquiescence. The granting to foreigners of exclusive ownership of and access to strategic national interests in tantalizing terms while Cuban citizens are denied property rights and excluded from tourist hotels ("tourist apartheid") has created deep social resentment against foreign presence in Cuba both inside the island and within the exile community.[126] Popular anger was put into sobering evidence during August 1994's riot in Havana; a tourist hotel and a dollar store were picked for attack by the angry mob.[127] The terms of some joint venture agreements could be le-

123. Castañeda and Montalván, "The Arcos Principles."

124. Castañeda and Montalván, "The Arcos Principles." As an example, the privatization of Emtel Cuba into a joint venture with Mexico's Grupo Domos was formed with an inexperienced company in the area of telecommunications and is said to have granted a 55-year monopoly in the telecommunications industry without a guarantee of efficiency and competitive prices and services. This agreement is considered illegal even within the framework of the current Cuban Socialist Constitution. Castañeda and Montalván, "The Arcos Principles."

125. "Insuring the Cuba risk," *The Cuba Report* (May 1996), p.7. Government export coverage entities of some countries from time to time reportedly provide specific credit coverage for some exports to Cuba such as food and named products. But even U.S. investments in Vietnam do not have access to Overseas Private Investment Corporation (OPIC) or Export-Import Bank financing because Vietnam, despite its far-reaching reforms, does not meet eligibility criteria of compliance with international laws on workers' rights and is still classified as a Marxist-Leninist country. Edward Gargan, "For U.S. business, a hard road to Vietnam," *The New York Times* (July 14, 1995). OPIC is a U.S. federal agency that helps Americans invest abroad; Export-Import Bank financing is oftentimes a key ingredient in large projects that have U.S. involvement.

126. This has been extensively documented by the media and in academic papers. Gillian Gunn remarks: "the degree of citizen outrage is evident... The government is aware that such as exclusion undermines one of its main claims to legitimacy—egalitarianism... The exclusion also flatly contradicts Article 43 of the Cuban Constitution." Gillian Gunn, "The Sociological Impact of Rising Foreign Investment," *Georgetown Cuba Briefing Paper Series*, No. 1 (1993), p. 8.

127. Cuban dissident leader, Leonel Morejón Almagro, has written a bitter account of the Spaniards in Cuba, known as *pepes*: "It's a tough pill to swallow -seeing the happy Spaniards in Havana driving around in their *Havanatur* rented autos while the Cubans exhausted, desperately hungry ...patiently wait for their infrequent and asthmatic buses... They justify their investment in Cuba with the same phrase over and over again: they're here to 'help the Cuban people.' ...it would be prudent for our peninsular friends to proceed with caution, because they're conducting business against the authentic will of the Cuban people and offending our national dignity... it is not inconceivable that at some future date some *different* Cuban government might well nullify these apparently secure contracts." See Leonel Almagro, "Spain: Cuba's Bitter Chalice," *The Miami Herald* (September 17, 1995). (Dr. Morejón Almagro is a Cuban lawyer nominated for the Nobel Peace Prize for his work with dissident lawyers and independent journalists and his advocacy of human rights and environmental causes in Cuba. He is currently in prison.)

gally challenged by a future government for this particular reason.

Other offshoots of the tourist-generated economy elicit the ire of the population. Doctors, educators, and other professionals—"good revolutionaries"—are earning 20 times less than those linked to the dollar economy through the self-employed sector or the tourist/foreign sector. With a few exceptions they are precluded from self-employment so they can pay back the investment the system has made in their education. "Health tourism" (turismo de salud) grants foreigners exclusive access to top of the line medical facilities, efficient service, and the latest drugs while the Cuban population is severely deprived of even essential medical services and the most basic supplies.[128] Discrimination and racism are added to the potentially lethal combination, as "there is evidence that there has been a reduction in the employment of blacks in the enterprises which are now part of joint ventures, situation very evident in the hotels and 'diplotiendas' catering to tourists."[129]

### 5. Negative impact on international public opinion

The last few years have seen a rapid rise in the international profile of issues related to transnational company ethics.[130] Multinational professional critics—particularly environmental and human rights lobbyists—have become more organized and appear to be gaining ground. Organizations dedicated to researching and evaluating the social and environmental records of corporations assign ratings and organize boycotts.[131] As a result, companies are increasingly sensitive to engaging in business which raise ethical questions and could lead to consumer boycotts, negative effects on staff morale, and the alienation of political contacts. Many big companies now take moral issues so seriously that ethics committees have been appointed and ethics codes drawn up.[132] In Cuba, three areas arouse particular public concern:

*i. Human rights:* Cuba violates most universally recognized economic and social rights, even by constitutional and legal mandate.[133] The United Nations General Assembly has passed resolutions condemning Cuba and signaling it as one of the most repressive countries in the world and international human rights organizations continue to call for worldwide condemnation of the Castro regime. The European Union recently refused to sign a commercial cooperation agreement with Cuba unless it shows advances in this area.

128. In the mid 1980's the government began promoting and in recent years has stepped up "health tourism," to generate hard currency. The State company SERVIMED was formed as a division of Cubanacán, S. A. to offer "sun and medical attention" to foreigners through programs which includes medical treatment, airfare and accommodations. Health tourism is developed through agreements with more than 200 travel agencies in more than 60 countries. It appears that the comparatively low cost of good quality care in Cuba with respect to medical centers in North America and Europe, is particularly attractive especially to Latin Americans. In 1995 health tourism reportedly brought in 3,500 tourists and generated hard currency revenues of US$24 million. See "One thing Cuba does right," *The Economist* (September 7, 1996), p. 42, and Sergio Beltrán, "Cuba: turismo contra salud," *Boletin del Instituto Cubano de Economistas Independientes*, Vol. 1, No. 1 (enero/febrero 1996), pp. 35-36.

129. Lago, "An economic evaluation of the foreign investment law of Cuba," p. 4.

130. Two recent examples are: 1) Shell's Nigerian operations were loudly criticized in the wake of the execution of seven human rights leaders in that country; and 2) Pepsi has been signaled for investments in Myanmar (formerly Burma) as human rights campaigners press for a boycott such as the one on South Africa. See Steth Mydans, "Pepsi courts Myanmar, preferring sales to politics," *The New York Times* (February 23, 1996).

131. "The fun of being a multinational," *The Economist, p. 52* warns: "Campaigners are also using new tactics. One is to take multinationals to court in rich countries for their behavior in poor ones. ...Another tactic it to lobby shareholders."

132. Of particular interest in this area are the Levi Strauss & Co. "Guidelines for country selection and for terms of engagement with business partners." See "The Denim Revolution," Research Report, Council on Economic Priorities (February 1994).

133. The United Nations Special Rapporteur for Cuba in an October 1995 report charges that strong repression is imparted by the state's security forces, indicating: "The excessive control exerted over the population via the institutional machinery ...is applied in the day-to-day life of every citizen -in the workplace, at educational institutions and even at the neighborhood level. ...[T]he deficiencies in respect to the protection of political and civil rights are so extensive and are so imbedded in the political system under the framework of the Constitution... that each case cannot be seen but ...as part of a general absence of pluralism."

In recent years Cuba's dissident movement has gained in strength and worldwide attention.[134] Human rights activists, inside and outside of Cuba, have specifically denounced foreign investors in Cuba for acquiescing or participating in socio-economic apartheid; some have even been signaled for aiding in the repression of peaceful dissident groups and human rights activists. Several groups have denounced a practice labeled "telephone apartheid" by which political dissidents are denied telephone services. The New York-based Committee to Protect Journalists has accused the Mexican Grupo Domos, of allowing its joint venture ETECSA to monitor and interrupt telephone communications of independent journalists.[135]

*ii. Labor rights:*[136] The advocacy of labor rights has also become more forceful in the international arena[137] while Cuba continues to be condemned by the International Labor Organization (ILO). for systematic violations of labor rights and encouraged to adhere to international human rights standards.[138]

In socialist Cuba, organized labor has been an instrument of the State and collective bargaining is unheard of.[139] The government denies legal recognition and persecutes independent unions and small labor groups which have emerged in recent years. Their leaders are dismissed from their jobs, blacklisted, tortured, incarcerated, and expelled from the government-controlled CTC (Central de Trabajadores de Cuba). United Nations reports cite cases of dismissal from work for citizens who have written slogans contrary to the government, carried foreign newspapers, expressed opinions, or engaged in activities deemed contrary the "construction of socialism."

The institutionalized abuse of ILO Convention 95 on the Protection of Wages, ratified by Cuba, provokes particular outrage. Cuba's unique confiscatory wage system of foreign joint ventures is said to resemble a feudal system of serfdom[140] "unparalleled in the legal tradition of Latin America."[141] In fact, because economic theory defines exploitation as paying a resource less than the value of its marginal product, the Cuban government, as the single buyer of labor, is engaging in a monopsonistic[142]exploitation of the labor force, usurping almost the entire value added of

134. In October of 1995 over 130 dissident groups formed an umbrella organization called *Concilio Cubano* to advocate for a peaceful transition to democracy and a rule of law. Its attempt to hold its first national assembly in February 1996 was violently repressed and received international media attention.

135. Sid Balman (United Press International), "Cierran las puertas de EEUU a unos ejecutivos," *El Nuevo Día* (17 de agosto de 1996); press release by the Miami-based *Grupo de Apoyo a Concilio Cubano* (May 27, 1996) with copies of letters of protest to Grupo Domos President Javier Garza and the General Director of the International Telecommunications Union in Geneva.

136. Lourdes Kistler, Program Officer of the American Institute for Free Labor Development (AFL-CIO) and Ernesto Díaz-Rodríguez, International Coordinator for a dissident Cuban labor group, provided valuable information for this section.

137. For example, in the United States there has been a recent popular outcry against child labor in the garment industry and a controversy over Nike's international labor practices, both receiving abundant media coverage. See Bob Herbert, "Nike's pyramid scheme," *The New York Times* (June 10, 1996), and Herbert, "Nike's bad neighborhood," *The New York Times* (June 14, 1996).

138. These rights are enshrined in the Vienna declaration approved by the World Conference on Human Rights in June 1993. The most frequently cited ILO violations are to Conventions 95, on the Protection of Wages; 87, on Freedom of Association and Protection of the Right to Organize; 29, on Forced Labor; 111, on Discrimination in Employment and Occupation; and 89, on The Right to Unionize and Engage in Collective Bargaining.

139. Labor rights have been essentially absent since Castro's rise to power. Upon Castro's victory in 1959 Cuba's independent labor unions were intervened and many of its leaders arrested, executed, or exiled.

140. Carlos Seiglie compares Cuba's labor system to a feudal economy in which the State is lord of the manor, the Cuban workers its serfs. See his "Cuba's Road to Serfdom," opinion piece submitted for publication (September 1996).

141. Sergio A. Leiseca, *Cuba: Rules Specifically Governing Foreign Investors,* Miami (February 15, 1994).

142. Monopsonist is Greek for "single buyer." Carlos Seiglie in his "Cuba's Road to Serfdom" argues that the Cuban government enjoys a monopsony in the labor market because it requires all firms to hire directly from the State.

labor to the production process.[143] Furthermore, employees of the tourist sector are subject to a series of specific duties and obligations, which include the extension to 180 days of the probationary period of new employees as well as 22 new obligations and 46 prohibitions; counting the 12 just causes for termination already incorporated in the Labor Code, these employees are subject to a total of 80 possible infractions. Law 132 of 1992 (Ley de Organos de Justicia Laboral de Base) further provides for eleven disciplinary measures which include fines of up to 25 percent of salary, the loss of material incentives, suspension of seniority rights, forfeiture of decorations and honors won by the workers and the replacement of private sanctions with public reprimand. The practice is even harsher than the text of the law; refusal to join paramilitary groups has been regarded as proof of opposition to the government and has led to dismissals or loss of benefits. [144]

Public objection is mounting against foreign acquiescence with and participation in the abuse of labor rights in joint ventures. An editor of The New Republic responded to Canada's outrage over the U.S. Helms-Burton law by pointing out that Canadians in Cuba participate of a labor system "that no Canadian would tolerate for five minutes."[145] A *Wall Street Journal* editorial on Cuba of August 1996 declares: "...foreign investors are essentially profiting by exploiting the Marxist government's reserve army of nearly slave labor."[146]

*iii. Environmental degradation:* In Cuba, environmental issues had been widely ignored until recent history. Not until January of 1981 did the Cuban government pass Law 33—Ley de Protección del Medio Ambiente y del Uso Racional de los Recursos Naturales—giving environmental regulations its first official role in the ecology and exploitation of the island's resources. But two environmental experts indicate in a recent study: "The document ...pales in comparison to existing international laws. ...[E]nvironmental regulations are seldom applied and the majority of decisions are taken without consideration of environmental effects."[147] Furthermore, the environmental structure designed for a centralized socialist economy is obsolete for a semi-capitalist economy.[148]

The collapse of the former Soviet bloc brought into evidence the extreme environmental degradation imposed by improper technology, the prioritization of economic goals, and the lack of accountability of an all-powerful State. Experts find Cuba to be no exception and express particular concern over the environmental implications of some recent foreign investments, particularly in tourism and mining.[149] Despite the discouraging state of affairs, awareness of the sig-

143. Raúl Asón, "Notas sobre los Principios Arcos para la inversión extranjera en Cuba," Cuba," *Cuba in Transition—Volume 4* (Washington: Association for the Study of the Cuban Economy, 1994), p. 372, states: "We are sure that this phenomenon doesn't occur anywhere in world with the exception of today's Cuba. This situation is too similar to slave labor, endured by humanity for many centuries, which we believed had disappeared."

144. Efrén Córdova, "The condition of Cuban workers under the *'Special Period in Peacetime,'"* in this volume.

145. Charles Lane, "Canada Sly," *The New Republic* (August 6, 1996).

146. *The Wall Street Journal* (August 5, 1996).

147. Barba and Avella, "Cuba's Environmental Law."

148. Collis, "Environmental implications of Cuba's economic crisis," p.8.

149. For example, the Canadian company Sherritt's joint venture with the Cuban government to mine nickel at Moa Bay, is said to present disturbing environmental problems. A special report published in *The Globe and Mail* of Toronto indicates that pollution at Moa is intense, particularly endangering the 60,000 residents of a nearby town. Nevertheless, Sherritt has allegedly committed to a significant environmental clean-up of the already polluted scenario (air and water), which is said to account for much of the $150 million dollars in spending promised for the next five years. But the company has said its aim is to have the Moa plant operating "in line with international practices," meaning "those followed in North America," *in five years"* (emphasis added). See C. Lane, "Canada Sly." Sherritt Inc. established formed in December of 1992 a 50-50 partnership with the Cuban government to mine nickel and cobalt using the Moa complex in Cuba's eastern shore and two Canadian subsidiaries to refine and market the minerals. The Moa plant had been built by the U.S. company in 1952. Paul Knox, "Cuba to share in Sherritt profit," *The Globe and Mail* (July 31, 1995).

nificance of this issue is growing in Cuba and internationally. Several dissident environmental groups have surfaced within Cuba in recent years, although, as with other independent groups, those not co-opted by the regime are facing huge political obstacles.

### 6. Industry-specific risks in the tourist sector

Aside from the prospect of future claims from former owners of confiscated lands where hotels now stand, the tourist sector is particularly vulnerable to political upheaval. The massive exodus by raft of the summer of 1994 is said by Cuban officials to have resulted in losses of around 100 million in canceled bookings during the last quarter of 1994.[150] In addition, repeat visits are diminished by deficient services resulting from the country's crippled infrastructure, its difficulties in obtaining imports, and lower service standards. Some tourists also experience anguish when confronted with the misery of the population and the system of tourist apartheid, vowing not to return.[151]

## FOREIGN INVESTMENT'S IMPACT ON INTERNAL REFORM AND EXTERNAL POLICY FORMULATION

### 1. What is reform?

Because the reform-generating capacity of commercial engagement is intrinsically tied to the definition of reform we subscribe to, for reform to be qualitatively or quantitatively evaluated in any meaningful way, we must define its objectives. A thoughtful consideration of this fundamental issue is often missing from the debate on commercial engagement and can lead to misunderstandings and conclusions which lack depth and affect the quality of the debate on Cuba. Therefore, for our discussion we will interpret reform as an issue of "empowerment," term which derives its significance from the meaning "to give power or authority to."[152] As a result, the meaning of reform for Cuba will be understood as the attainment by its people of self-determination—the authority to freely decide a system of government and elect an accountable political leadership and the attainment of universally accepted civil, political, and economic rights under the protection of a rule of law. (This may be generally understood as a free market-oriented, pluralistic democracy.)

In order to assess the potential for reform of foreign investment/commercial exchange, we must address its actual and possible impact in the context of Cuba's overall economic needs and how it is leading or could eventually lead to the empowerment of the Cuban people.

### 2. Commercial engagement as an instrument of economic and socio-political reform in Cuba

Michael Peters, in his book *International Tourism,*[153] advances a theory on the effects of tourism and identifies five potential benefits for a local economy. Given Cuba's almost four decades of isolation from foreign influence and investment, it has been useful to borrow freely from Peter to address the overall impact of foreign investment. Four of these variables have to do with repercussions on the economy: 1) creation of employment; 2) generation of hard currency earnings; 3) multiplier effects; and 4) dispersion of development to other sectors. A fifth—sociological impact—will be analyzed in respect of the other four, all *vis-á-vis* our definition of reform.

*i. Creation of employment:* Foreign joint ventures are cited as "officially" employing 60,000 workers.[154]

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150. Michael Becker, "Tourism misses its goal," *CubaNews*, Vol. 3, No. 2 (February 1995), p. 8. Cuba's Deputy Minister of Tourism has expressed disappointment with the 15 percent annual increase in tourism revenues in 1994, short of a projected 30 percent.

151. The author has received several first-hand accounts from visitors not of Cuban origin.

152. *Webster's New World Dictionary of the American Language*, Second College Edition (Cleveland: The World Publishing Company, 1972), p. 459.

153. Michael Peters, *International Tourism* (Hutchinson Publisher, 1969), cited in Gunn, "The Sociological Impact of Rising Foreign Investment," p. 6.

154. "Castro keeps reform on the leash," *Financial Times* (October 27, 1995) and *The Cuba Report* (July 1996), p. 8. Although Minister Lage had reported that tourism alone provided 59,000 jobs in 1992. Gunn, "The Sociological Impact of Rising Foreign Investment," p. 9.

This means that a mere 1.3 percent of the working age population—or 1.87 percent of the estimated employed population—is employed in foreign joint ventures.[155] With the unemployed said to be topping over a million, this is not significant in alleviating Cuba's grave unemployment crisis. In fact, the State is actually blocking opportunities for the creation of more jobs. Due to Cuba's singular labor system, the State is the only "buyer" in the labor market, or in economic terms that the state acts monopsonistically. By refusing to allow other buyers to bid on this important input of the production process, the government has eliminated market forces which would determine the price of labor competitively. Because it fixes a high price for labor in foreign joint ventures irrespective of internal and external competitive market forces, it actually discourages and limits optimal employment by foreign capital firms. That is a level of employment at which, given the conditions of the market, the cost of labor would almost surely be lower. (Cuba, as we have seen, is not close to being competitive on labor costs.)

Furthermore, the limited number of jobs available for a huge pool of workers in the most desirable sector of the economy actually reinforces the need to play by the government's rules. (The State maintains, as we have seen, strict control over these workers.) As a result, notwithstanding the importance these jobs have for those who attain them, as an element of reform or empowerment, the employment aspect of foreign investment seems relatively meaningless and, in important respects, even detrimental.[156]

*iii. Generation of hard currency earnings:* If we take the US$751.9 million in total stock of "delivered/ committed" investment reported by the U.S.-Cuba Trade and Economic Council for August 1996 and round net earnings to 33.3 percent,[157]assuming Cuba receives an average 50 percent share[158] (a 50/50 partnership generating $248 million), it would be obtaining net earnings of $124 million per annum, or roughly 2 percent of the estimated US$6 billion of the missing annual Soviet assistance. Since these figures for foreign investment are probably significantly inflated, we can assume the results would actually be lower unless a higher capital return ratio is factored in. In fact, Minister Lage has indicated that Cuba's net income from foreign joint ventures for 1995 was merely US$114 million (representing 3 percent of the country's net income),[159] which would suppose a higher return ratio on investments amounting to less than the cited US$751.9 million. In addition, this—which must be income from operations typically amounting to around 30 percent of total earnings—would bring the government an additional US$97.5

155. For 1995, the estimated workforce was 4.3 million and the estimated employed population was 3.2 million. See Mario Zequeira, "Labor and self-employment: a dilemma for the state," *CubaNews* (September 1996), p.9. Minister Lage, however, has recently indicated that the foreign joint ventures employ 5 percent of the workforce.

156. Its significance, however, could be heightened by the foreign joint ventures' support needs of certain services and goods, which theoretically generate demands on the State to unleash market forces and allow for private enterprise and self-employment. Nevertheless, it is uncertain whether it can actually bring about meaningful changes in the future.

157. An assumed 3-year rate of return of capital is said to be an average minimum return required for high risk cross-border investments. In fact, an expected 3-year capital recovery ratio is said to be characteristic of foreign joint ventures in Cuba. For example, with regard to British American Tobacco's Brazilian subsidiary, Souza Crus, and the Cuban Tobacco Union, which produce cigarettes through a joint venture (the brand Continental for export, and the brand Popular for the domestic market), it was reported that the initial US$10 million investment in the project was expected to be recouped in 3 years. See USCTEC, *Economic Eye on Cuba* (7-23 June 1996), p. 2.

158. The average investment is said to give Cuba at least 51 percent ownership of joint ventures, although this varies. For simplification, we will assume 50/50 partnerships as a norm.

159. Lage revealed this number before year-end 1995 in an address to Central Committee members as an estimated figure. We can deduce that the net income referred to is $3.8 billion. See *Prospects for Development in a Free Cuba*, Executive Summary, U.S. Cuba Business Council, undated. After year-end, it was confirmed by the government. Yet Lage had previously reported that tourism was earning Cuba an estimated $400 million in hard currency just in the year 1992. See Gunn, "The Sociological Impact of Rising Foreign Investment," p. 8. This reference was probably to gross revenues, but "lax" use of data by government officials leads to much confusion.

million in tax revenues.[160] But whether the total is US$114 million net of taxes or US$211.5 million including tax revenues, given the huge gap left by the loss of Soviet assistance, neither sum constitutes a very heartening overall profit for Cuba from foreign joint ventures.

Tourism, as we have seen, has been the fastest growing sector of the Cuban economy. The impact of tourism revenues appears significant; Castro declared in July 1996 that tourism brings in an even larger gross revenue than the sugar industry.[161] But net revenues for this sector are estimated to be low due to its high dependence on imports and hefty promotional discounts and a number of obstacles are said to hurt profitability. Cuba reports that costs per dollar of income dropped in the first half of 1996 to US$0.68 from US$0.73, while income per tourist day increased from US$80 to US$87, but these figures are highly questionable.[162] Shedding doubt on Cuba's numbers, an analyst explains:

> "...government statistics just don't add up. If we are to believe the latest published report, Cuba's tourists spend more than twice what a tourist spends in the Dominican Republic, a much more mature and developed tourist market. And what's more amazing, they spend $4 more per visit than do tourists to the U.S. This from an industry that generated almost no revenue seven years ago."[163]

In fact, it has been calculated that for tourism to replace the sugar and nickel earnings that Cuba had in the 1980s, it would have to bring in 3 million tourists per year, a level which would require one billion dollars in additional investment, a highly improbable achievement.[164]

Revenues from a few joint ventures in sectors other than tourism have ostensibly been considerable yet seem relatively insignificant as a solution to the economic crisis.[165] Yet at this time of severe economic crisis, any revenues—those derived from earnings or

160. Assuming Cuba had a 50 percent share of every joint venture, earnings before taxes would total US$325 million, as a 30 percent tax would net US$97.5 million for the government. Net income after tax would equal total US$228 million, of which 50 percent represents $114 million in revenues for Cuba, the figure reported by Lage for 1995.

161. "Castro comments," *The Cuba Report*, Vol. 5, No. 4, p.6.

162. *The Cuba Report* (August 1996), p.4. This means that in 1995, 745,000 tourists would have left Cuba US$324 million if the average visit was 5 days or US$453.7 million if the average visit was 7 days. But, this is questionable: in the Bahamas, despite good gross revenues from tourism, 81 cents on the dollar are going overseas via partner corporations. See David Reiff, "Cuba Refrozen," *Foreign Affairs* (July/August 1996), p. 65.) For an idea of the discrepancy in figures, consider the following: For 1994, when the number of tourists increased by 13 percent, Havana Asset Management estimated that gross tourism receipts of around $800 million netted just $250 million. In March of 1994, a Cuban economist on a visit to the United States privately stated that a 30 percent rate of return by Cuba for tourism was too high. Statement by Pedro Monreal, of the *Centro de Estudios de América*, at meeting of the *Cuban American Research Group*, New York, March 16, 1994.

163. T. Babun, "Cuba's investment boom that never was."

164. Ana Julia Jatar-Hausmann, "Through the cracks of socialism: The emerging private sector in Cuba," in this volume.

165. For example, the Sherritt investment in the Moa Bay nickel plant, as of December 1994 was said to be contributing to the Cuban government half the earnings from sales of finished nickel made by Sherritt's refinery in Alberta (half of $26.6 million, or US$13.3 million) in addition to its share (wage and social security confiscation and labor utilization taxes) of the $16 million annual payroll at Moa Bay. See Lane, "Sly Canada." Labor utilization earnings could reach an estimated US$19 million, which is about one third more than earnings from operations. Assuming a 95 percent wage retention rate, salary confiscation equals US$15.2 million, social security conversion would net roughly $12 million and labor utilization taxes would bring in $1.8 million.) Nonetheless, total earnings for Cuba of $29.3 million per annum from Sherritt's Moa operation are relatively low relative to Cuba's needs, especially considering this is presumably Cuba's most visible joint venture investment. Sherritt International Corporation incorporates Cuban holdings as well as oil production facilities in Spain and Italy and exploration properties in a number of countries. Second quarter 1996 earnings totaled Canadian dollars $74.3 million. See T*he Cuba Report* (June 1996), p. 4 and (September 1996), p.6. Sherritt International Company was reported by Cuba's *Prensa Latina* to have declared net profits of US$8.47 million during the second quarter of the year. Assuming Cuba represented *all of its business*, which it doesn't, a 50-50 partnership between Cuba and Sherritt, would leave the Cuban government with equivalent annualized net earnings of $33.8 million from operations, plus an additional $20 million in taxes at a 30 percent rate, for a total of US$53.8 million, but the figure is actually lower by an unknown amount, as Sherritt International's business outside of Cuba must be taken into account. That inflated amount would still equal less than 1 percent of the loss of annual Soviet assistance of US$6 billion.

those obtained from the "utilization" of labor—are, doubtless, highly valued by the Cuban government.

To put into perspective Cuba's overall low net earnings from foreign investment and understand its underlying rationale, it is essential to consider what Cuba must be offering as enticement to investors. Given the traditional investment/lending premise that the higher the risk the higher the required return, and in light of the relatively high labor costs, many analysts assume that Cuba's desperate situation is forcing a "fire sale" of available assets.[166] Only this would allow the investor fast capital recovery through the generation of high earnings, which also benefits the Cuban partner, a State in desperate need of revenues.

The wage retention arrangement is a guaranteed and most lucrative source of hard currency earnings for Cuba—irrespective of how profitably joint ventures operate. Earnings from Cuba's unique system of labor in foreign joint ventures could total more than three times the net earnings from operations reported by Minister Lage for 1995.[167] With a reported 60,000 workers in the foreign investment sector, the State could be making in wage conversion alone an estimated US$26.5 million per month, equivalent to around $317.5 million per year.[168] Additionally, social security contributions (14 percent of wages) paid by the joint ventures in hard currency are registered by the State on behalf of the workers in pesos at the artificial one-to-one exchange rate, would leave the government an additional US$3.6 million per month, or US $43.3 million per annum. Furthermore, a labor utilization tax of 11 percent of gross salaries would net US$2.97 million more per month, US$35.6 million per year. In all, roughly US$33 million per month, US$396.8 million per year, could be going into the government's coffers.[169]

The confiscation of wages is obviously detrimental to joint venture workers, reported to be receiving salaries equivalent to those employed by the State, -currently around nine dollars per month. The government, thus, is appropriating on average almost 98 percent of the total value added of labor in the production process—in some cases even higher;[170] this in effect, imposes an enormous tax on the workers. Workers in the tourist sector are, however, much better off thanks primarily to tips.[171] Although they are required to turn over up to 75 percent of their foreign currency tips to hotel management, receiving an equivalent sum in pesos calculated a the official one-to-one rate, non-compliance with the tips' rules is reported to be high (it does, however, lead to termination of employment).[172]

166. Lago, "An economic evaluation of the foreign investment law of Cuba," p. 4.

167. On a monthly basis, the State would be obtaining an annual gross profit of US$5,289 per worker (US$441 per month). At the current peso-dollar exchange rate of 1 US$ equal to 22 pesos, if the employment agency is receiving US$450 per worker and the government pays a salary to each worker of 203 pesos, the State has retained 97.9 percent of each worker's wages.

168. This is a rough estimate based on the average salary of US$450, paid to workers as 203 Cuban pesos (subject to a retention rate of 97.9 percent) times 60,000—the number of workers said to be employed in foreign joint ventures. The number of workers on the average salary is not known, but it is reasonable to assume that the majority would be earning a similar amount.

169. This is equivalent to 66.5 percent of Cuba's entire 1995 estimated GDP of 13.125 million pesos if we converted it to dollars (US$596.5 million) at the current rate of 22 pesos to the dollar. Neverthelss, this is a mere allusion to the proportions involved, as Cuba's GDP figures are not reliable. José Alonso, Research Economist at USIA's Radio Martí, explains that analysts don't know how this calculation is made. It reflects 1981 constant dollars, but that year's basket of goods is no longer available, as it was the period of massive Soviet aid. Furthermore, the components and methodology used to calculate the price deflator are unknown).

170. The Cuban state employment agency, however, is reported to receive US$2,700 per month for a geologist employed in Sherritt, while the geologist receives US$10.00 from the government. See Lane, "Sly Canada." In this employee's case, the wage confiscation provides a 99.6 percent return for the government—US$32,280.00 annually.

171. In 1993, it was reported that at one Varadero hotel that a waiter turned in US$609 in tips in just one month, "bringing his total income for the month to nearly 1,000 pesos, five times the national average." (Gunn, "The Sociological Impact of Rising Foreign Investment," p.10.) *It should be noted, however, that at the time, 1,000 pesos roughly represented just US$10 at the black market rate.*

172. An average confiscation rate of 75 percent was reported to the author, although rules are said to vary by enterprise. Based on personal conversation with specialist in Cuban labor, Professor Efrén Córdova of Florida International University, August 1996. Assuming a 50 percent non-compliance rate on tips of around $300 per month, a worker could take home over US$187.5 per month which is a fortune in Cuba ( $37.50 in 25 percent of the reported $150.00 plus the $150.00 not reported).

Despite the poor wages, the material conditions of workers in the foreign enclaves is better than the rest of the population's, which make jobs in this sector the most prized. Foreign enterprises have found many resourceful ways of compensating workers, including bonuses and gifts.[173] Many workers receive transportation to work and meals; in some cases dress is provided. In the tourist sector, aside from tips, some hotel workers are able to eat the food served at the restaurants and are sometimes allowed to convert tips into left-over food from the hotel's restaurants.[174] Emulation prices given to the workers—bicycles, TVs, etc.—are said to be highly valued, although worth less than the hard currency tip earnings of the winner.[175] Some of these benefits have recently carried over to other areas, as the government has started to provide incentives for non-joint venture workers in order to compensate somewhat for the growing inequalities arising from the dollar-peso dual economy. Approximately one million workers, or 25 percent, of the labor force, is estimated to be receiving some form of payment in dollars or convertible pesos, as reward for meeting or exceeding work quotas.[176] Despite this positive side effect, those workers remain dependent on the State.

The informal incentives provided by joint ventures provide a significant measure of relief to the workers, given the impoverished state of their lot. But relative to empowerment, providing basic guarantees available to workers in most developed and developing countries scenario means little more than putting food in hungry stomachs, allowing the favored workers to get by somewhat better than the impoverished rest. Its importance for the favored individuals, from a humane perspective, should not be underestimated, but at a systemic level, its overall impact on empowerment is trivial. Importantly, as we have seen, because these jobs are more precious, those employed by joint ventures also have more incentive to "behave." Therefore, any material improvement in the situation of joint venture workers is at the expense of even greater political compliance and economic dependence.[177]

Clearly the Cuban government is the main beneficiary of the hard currency earnings derived from foreign investment. These are especially valuable for regime security during the "Special Period." Nevertheless, in relation to the huge needs of the country after the loss of Soviet funds, hard currency net earnings derived from non-telecommunication joint venture foreign investment, estimated here to approximate roughly $608.3 million per year (10.1 percent of one year's estimated Soviet assistance[178]) do not come close to enabling a significant improvement in the economy with meaningful trickle down effects.

Despite the peculiarities and deficiencies of existing joint venture arrangements, foreign investors are rationally interested in the survival of the current Cuban government and its investment agreements for

173. In testimony given in private by an executive of a Chilean firm investing in Cuba, the investor acknowledged being aware that the peso salaries of workers had virtually no purchasing power. Yet, the workers of one of their operations, adjacent to a similar State-owned operation, were reporting to work while the State's operation was plagued with absenteeism. As he explained, they were being lured to work because "we give them lunch."

174. Gunn, "The Sociological Impact of Rising Foreign Investment," p. 10. At one hotel, those employees with the highest hard currency tips obtained the food surplus.

175. Gunn, "The Sociological Impact of Rising Foreign Investment," p. 10.

176. See Jatar-Hausmann, "Through the cracks of socialism," p. 13.

177. "In order to attract capital the government has promised investors the right to hire and fire as they see fit." See Gunn, "The Sociological Impact of Rising Foreign Investment," p.12.

178. Soviet assistance has been estimated earlier in this paper at more than US$6 billion, a figure rounded down for this calculation to US$6 billion. Earnings were calculated as follows: $114 from operations (Minister Lage's report for 1995), $97.5 million in taxes of 30 percent on $751.9 million foreign investment per Table 2, plus our estimates of $396.8 million in labor utilization earnings. (Tips were not included in this figure, as it is very difficult to estimate a reliable number.) Telecommunications' payments made by U.S. companies to Cuba totaling $76.8 million in 1995 would bring the total to $685.1 million. See *U.S. Cuba Policy Report*, Vol. 3, No. 10 (October 31, 1996), p. 3.

the minimum period required to secure capital recovery, indefinitely to generate a stream of earnings.[179] In fact, due to the nature of foreign investment in Cuba today, the conditions and terms for the generation of earnings seem to actually reinforce the vested interest both of the State and of foreign investors to preserve existing joint venture arrangements. These have been designed to maximize short-term benefits for the partners—foreign investors and the Cuban State—in the context of a command economy and a closed political system.

*iii. Multiplier effects:* The characteristics of foreign investment in Cuba have prompted the observation: "Hardly any of the companies ...produce consumer goods for Cubans. (...)They concentrate instead on extractive industries such as nickel and petroleum exploration, providing services for foreign tourists, and export-oriented industries that net hard currency for the Castro regime and little for the Cuban people."[180] As a result, foreign joint venture investment has not affected overall domestic production—furnishings, food, supplies, athletic equipment, etc.—in any significant way. In the tourism sector, it has generated support businesses, but mainly in the service sector. A visiting scholar poignantly illustrates this paradoxical situation: "...the Castro government has steadfastly refused to allow Cubans to set up the small or medium-sized businesses, even to supply the tourist sector. The shampoo in hotel bathrooms, the pillow on the bed, even the packets of sugar in the hotel restaurant- all are imported. The last is particularly astonishing: the sugar, packaged mainly in Canada, was produced on the island."[181] Severely restricted multiplier benefits are a poor precursor of reform.

The economic benefits of multiplier effects emanating from worker remuneration are also quite limited in scope due to wage confiscation. Because the estimated number of workers employed by foreign joint ventures is said to be no more than 60,000 and the average size of the Cuban family is four,[182] approximately 240,000 people can be assumed to depend on those jobs, or around 2 percent of the Cuban population. But the possible benefits to those workers and their families are severely constrained by the salary confiscation scheme, which limits their multiplier effects—the most notable exception being workers of the tourist industry with access to tips. But, if we assumed 40,000 workers to be employed in tourist joint ventures and taking home US$187.5 a month in tips, the US$7.5 million per month would have an impact on the economy but cannot materially change its overall condition.

In terms of empowerment, due to wage confiscation in joint ventures, advances are probably most perceived by the population not in the joint venture sector, but in the informal and self-employed sectors. Castro himself has acknowledged the impact on tourism on employment, indicating that tourism supports (rather than employs) 2 million people.[183] But the government has imposed steep taxes and fees to "redistribute" individual gains.[184]

From the Cuban State's standpoint the rationale for foreign investment is the prioritization of political necessities over structural economic reform while extracting immediate economic gains to face a monumental crisis. From the standpoint of the investor, Cuba's high risk scenario imposes an essentially spec-

179. Peter Breese of Latinvest Security Limited of London, speaking at a June 1996 The Economist Conference on Cuba held in London, made recommendations for investing in Cuba which included: "remember particularly to structure the offer recognizing the investors' requirement to combine a limited exposure with a realistic exit strategy." See *The Cuba Report* (June 1996), p. 5.

180. Frank Calzón, "Is Canada aware of evil of cutting deals with Cuba?" *The Miami Herald* (April 15, 1996).

181. Reiff, "Cuba Refrozen," p. 65.

182. Zequeira, "Labor and self-employment."

183. On July 26, 1996 Castro reported that tourism supports 2 million people, not 2 million workers. See "Castro comments," *The Cuba Report*, Vol. 5, No.4, p.6.

184. Given the difficulty of measuring the overall economic impact of tourism -due to the impossibility of assessing the size of the informal sector and its specific effect on it—we can only assume that tourism indeed is of considerable consequence to the economy when tourist related-services such as taxis and *paladares*—are taken into account.

ulative and short term rationale: limited initial capitalization with a focus on recovery instead of reinvestment. This scenario is contrary to the local economy's need for capitalization, which is what enables the creation of domestic savings and spurs internal growth. Thus, the nature of foreign investment in Cuba today is incompatible with stable and long-term economic growth.

*iv. Dispersion of development:* In Cuba, the people's eager embrace of capitalism has scared the government.[185] As a result, following the success of free markets, vendors have been swept away and many small restaurantsi—ipaladares—shut down. Nevertheless, certain elements of this second economy tied to foreign capital are harder to control and could trigger, through a "dispersion" effect, elements of reform:[186]

- The second economy is regarded as an instrument to create avenues for civil society to manifest itself as distinct from the state. Foreign joint ventures provide a living example of an alternative to the official centralized command system. When juxtaposed with the administrative and inefficient setting of prices, this can underscore the efficacy of decisions based on supply and demand and profit orientation—which could lead to demands to eliminate senseless regulations and administrative restrictions. Additionally, it helps to demonstrate that economic relationships outside of the official sphere can operate efficiently and affirms market worth based on tradeoffs.[187]

- Cuba's capitalist enclaves have required the development of support enterprises that did not exist, particularly in the tourist sector. This, together with the success of self-employment, can help dispel the myth that decades of socialism have eliminated private initiative and entrepreneurship, demonstrating that the citizens can react positively to the pursuit of private gain.

- Foreign joint ventures carry the seed for the emergence of an entrepreneurial class which would be psychologically prepared for the transition to capitalism.[188]

These three factors, linked to the emergence of foreign joint ventures, lead to the logical question of the role played by state pseudo-technocrats involved in the opening to foreign capital. At present their dual roles as Party apparatchicks and agents of reform mean that they must remain ideologically committed to the system while recognizing that radical economic changes looking too much like the hated capitalism must be implemented. Moreover, because tomorrow they will probably have to survive in the market, to different degrees they're already positioning themselves. Expectations of their psychological transformation and/or political trajectory from socialism to the market are difficult to assess given their precarious situation and the high degree of pretending that permeates all levels of Cuban society. Because survival can be a deceitful game, we can only speculate on how much capitalist influence would actually encourage and strengthen their commitment to reform. The key for reform, however, is their eventual attainment of any degree of significant influence to bring about change. As of today, their actual economic and political empowerment and influence appears to remain resolutely dependent of and

185. The leadership realizes that by "creating alternatives for employment outside of the state sector, the second economy empowers workers and makes it more likely that their wage and conditions of work will result from transactive bargaining between workers and managers than imposed from the center, putting pressure on the first economy for change." See Jorge Pérez-López, *Cuba's second economy* (New Brunswick: Transaction Publishers, 1995), p. 22.

186. Applied to situations described in Pérez-López, *Cuba's second economy,* pp. 14-15.

187. Pérez-López, *Cuba's second economy*, p. 17.

188. For example, it has been argued that the very presence of a second economy in the former Soviet camp led the way to, and even necessitated, economic reform. See Jorge Pérez-López, "Cuba's second economy and market transition," draft of March 25, 1995 prepared for the conference *Towards a New Cuba*, Princeton University, April 7-8, 1995. Analysts, however, hold differing views as to what led to perestroika and glasnost.

under the control of the State.[189] It is, thus, questionable whether "technocratic metamorphosis"[190]—the transformation of a select few "enlightened" State technocrats linked to foreign joint ventures—could enable a change in Cuba.

A "make-over" of the technocracy, however, seems more consequential once a transition (i.e. a process of empowerment) is actually underway. These technocrats could add a level of experience, a possible second tier which could quickly turn away from revolutionary rhetoric, fully embracing the ways of the market and benefiting the privatization process. But the development of this new socio-economic segment also breeds the seeds of destructive societal forces, particularly in case of an eventual transition. Cuban managers of foreign joint ventures could be posed to assume undue power and control during the chaotic phase of a transition.[191] Professor Gunn, of Georgetown University, indicates: "The extremely high concentration of resources in the state sector, and the centralized nature of the management system ...place a greater deal of power in the hands of government officials of socialist countries. ... Economic reforms and the transition to a market economy create opportunities for the nomenklatura to ransack what they can from amid the chaos of disintegration and lack of regulation."[192] In fact: "Many in leadership positions may actually be creating more incentives for themselves to preserve the regime that allows them their privileged position. In Cuba, a system of privilege based on political allegiance has, in fact, been a "subtle weapon of control;"[193]to varying degrees it permeates different levels of the technocracy.[194] As a result, the role of State technocrats must be carefully assessed.

Foreign investment, whether in the tourist sector or beyond, can also be associated with a dispersion effect on the general population such as what Peters labels "demonstration effect on consumption"—foreign consumption patterns, dress style, access to technology, vehicles, restaurants, etc. and accompanying idiosyncrasies. This is linked to the sociological effect of "a widening, new, understanding of foreigners and foreigners' tastes."[195] But, for it to have any meaningful impact, the premise that people can make economic decisions freely seems somehow implied. A prominent expert on Cuba concluded in late September 1992 after a series of visits to Cuba, that the ideologically subversive effects of foreign investment were not at the time severely disrupting Cuba's social fabric."[196] Several years later, although foreign joint ventures appear to not have proliferated, the

189. Minister Carlos Lage's words underscore the nature of their role: "In these existing joint enterprises the Cuban managers are not capitalist or the owners of those facilities. They are members of the Revolution performing the task assigned to them by the Revolution." Gunn, "The Sociological Impact of Rising Foreign Investment," p. 3.

190. Term borrowed from James Shinn, "Engaging China: exploiting the fissures in the facade," *Current History*, Vol. 95, No. 602 (September 1996).

191. *The Economist* recently indicated: "The youngish technocrats who make up the second tier of Cuban government include some impressively intelligent and cultivated men." See "Cuba Survey," *The Economist* (April 1996). This terminology, *pseudo-technocrat*, is chosen by the author due to the fact that in Cuba, to reach these heights of becoming a high level technocrat requires proven political commitment in addition to technical or professional qualifications.

192. Gunn, "The Sociological Impact of Rising Foreign Investment," pp. 23 and 25.

193. Gunn, "The Sociological Impact of Rising Foreign Investment."

194. Since the early days of the Revolution the *nomenklatura* has enjoyed exclusive privileges because rational actors will not allow their investments and interests to be ruined, they will seek to protect their privileges. In Juan Clark, "The Cuban new class," *The Miami Herald* (February 25, 1996). In fact, the younger and well-educated technocrats, state enterprise managers and some party bureaucrats may share a similar situation with those outside the elite who benefit from a second economy and are consequently dissuaded from demanding reform: "(...)the individualistic, wheeling-and-dealing oriented, personalized subculture created by the second economy does not encourage the kind of collective action necessary for revolution and the violent overthrow of a regime." Pérez-López, *Cuba's second economy*, p. 15, quoting Sik.

195. Gunn, "The Sociological Impact of Rising Foreign Investment," p. 6, quoting Michael Peters and John Bryden.

196. Gunn, "The Sociological Impact of Rising Foreign Investment," p. 15.

Cuban people are certainly well aware of their existence. Despite their consequential social repercussions, the rivalries and distortions which have surfaced in their wake have remained under strict state control. Undoubtedly the free markets have revived and encouraged the entrepreneurial spirit of the Cuban people,[197] for the first time in over three decades exposed to the ways of the market. Cuban managers and workers employed in joint ventures and the population at large witness the capitalist model and work ethic, supply and demand, competition, marketing, and efficiency. Nonetheless, if a widening of understanding indeed taking place, the crucial issue is: can it, and if so, when does it, actually lead to reform/ empowerment? In fact, although foreign investment may continue to transform the psychology of those who come in contact with Capitalist ways—both managers and workers, not much can change if their capacity to influence or undermine the current system remains suppressed. In a totalitarian or repressive regime, empowerment seems independent of the psychology of any given individual or group as long as they lack the capacity to effectively exercise power.

Meanwhile, the destabilizing distortions of Cuba's unique breed of selective capitalism are obvious. The creation of a worker elite, particularly in the tourist sector, is causing friction with the rest of the population and fueling socio-political tensions.[198] Reports from Cuba describe growing internal anxiety over this problem.[199] Those who have dollars, approximately 40 percent of the population at any given time,[200]can go to state-run shops to buy goods virtually unobtainable in their ration books or in peso stores, although they are wildly expensive. Those who do not must turn to the "informal" economy, which touches most of life and breeds pilferage, corruption, and theft. Common are anecdotes of girls prostituting themselves for a dinner at a dollar-only restaurant or a pair of jeans. The government has attempted to iron out these inequalities by redistributing wealth through taxation, making those who've profited bear the burden for the rest of society, but nationalistic resentment is festering, even among high government officials and those most faithful to Castro.

Another distorting occurrence associated with the advent of foreign investment is the emergence of quasi-private or private Cuban companies involved in foreign joint ventures, manipulated by the party as "a mechanism for maintaining leverage in a market system."[201] Due to the government's fears that the creation of increasingly independent economic agents may dilute the formal power structure, a concentration of "privatized" financial resources and capital has taken place within the ruling elite, particularly within the Cuban Armed Forces (FAR). Since Cuba's opening to foreign investment, several "private" Cuban companies—so-called S.A. firms[202]—have been officially established, especially in the tourist sector, which are professedly run and owned by the

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197. It should be noted that Cuba pre-Castro was primarily a market economy, and quite successful, despite its political "underdevelopment."

198. Tourism workers have been said to be dressing so well as to be mistaken for foreigners. See Gunn, "The Sociological Impact of Rising Foreign Investment," p. 11.

199. An economist from Cuba explains: "A process of redistribution of income in the hands of the population has been undertaken....This situation of divisive gaps ...has been insulting and has worsened something which had been happening—the separation of ethical and esthetic values." Marta Beatriz Roque, "Una ventana a la sociedad cubana," *Boletín del Instituto Cubano de Economistas Independientes*, Vol. 1, No. 1, (enero/ febrero 1996), p. 37.

200. A large portion of that 40 percent is reported to have only occasional access in small quantities. "Country Report / Lage...," *The Cuba Report* (August 1996), p. 5.) Prior to the legalization of the holding of dollars, in March 1994, Pedro Monreal, an economist visiting the U.S. from Cuba, stated that the government estimated that 15 percent of the population had access to dollars from abroad at a meeting of *the Cuban American Research Group*, New York, March 16, 1994.

201. Gunn, "The Sociological Impact of Rising Foreign Investment."

202. S.A. is the abbreviation of *Sociedad Anónima*, and stands for Inc.

FAR, reportedly with foreign participation.[203] In essence, the military is being used as a vehicle to access the market in a more controlled manner and co-opt the benefits of capitalism. Marinas, hunting lodges, spas, and small hotels built for the military and the Party are used to generate foreign exchange from tourists. The new firms generally seek partnerships with foreign companies as they grow and are also said to be acting as consultants to foreign investors and clearinghouses for counter-trade deals between foreign and Cuban enterprises and providing services for firms marketing visitors.[204] Their shareholders, the origin of their capital, and their earnings are shrouded in secrecy; the vested interest of the Cuban owners is, naturally, to preserve the exclusivity of these privileges. Although this has been labeled "a state-sanctioned capitalist sector,"[205] because this "leadership-contained" mechanism limits empowerment and multiplier effects, it seems begging of a more descriptive label—which might be "captive or co-opted capitalism."

Concurrent with the concentration of resources in the hands of the nomenklatura, Cuba is witnessing the emergence of another troubling phenomenon linked to foreign capital. Similar to the post-Soviet Russian mafias, a new class has been born: Cuban yuppies or "new rich"— the macetas,[206] black marketeers and individuals who, thanks to the liberalization of certain markets, command large amounts of financial resources and consume conspicuously.[207]

The perpetuation of selective capitalism has harvested destructive societal distortions and harbors the seeds of increasing socio-economic aberrations, sabotaging the eventual establishment of an appropriate framework for achieving social order and a rule of law. Cuba's singular arrangement to access foreign capital through leadership-contained, quasi-Capitalist mechanisms, could best be described as "co-opted dispersion of development" or "distorted dispersion of development." Economist Jorge Sanguinetty has warned that the lack of equity in the privatization process taking place with foreign investor participation excludes most of the non-militant population and "may cast serious doubts on the legitimacy of property rights for a long time and is not a desirable outcome of an effort to establish a market economy."[208] The elite could be poised to take over a "reformed" Cuba while the population at large has been denied access to properties and business dealings available only to foreigners and members of the nomenklatura. (The current situation in Russia offers

203. Two of the most prominent enterprises are in the tourism sector: Cubanacán, S.A. and Gaviota, S.A., both with extensive joint ventures

204. The apparent strategy is to establish Cuban firms able to compete for "spin off" business from major foreign investments. Jorge Pérez-López notes that other non-military members of the *nomenklatura* are already also going into business. See Gunn, "The Sociological Impact of Rising Foreign Investment," p. 3; Pérez-López, *Cuba's second economy*, p. 33; and *The Cuba Report* (August 1996), p. 8.

205. Gunn, "The Sociological Impact of Rising Foreign Investment," p. 13.

206. The uneven distribution of existing wealth is evidenced by the fact that 59 percent of deposits in the Banco Popular de Ahorrro have been reported to be in the hands of 10 percent of the depositors, who held 80 percent of the cash. See "Las finanzas internas y el mercado agropecuario," *Boletín de la Asociación de Economistas Independientes de Cuba*, No. iii (marzo-abril 1995), p.16; Arnaldo Ramos Laurzurique, "La crisis económica cubana: causas y paliativos," *Boletín del Instituto Cubano de Economistas Independientes*, Vol. 1, No.1 (enero-febrero 1996), p. 3; and USCTEC, *Economic Eye on Cuba* (15-21 July 1996), p.3.

207. This special class is said to drive flashy cars and talk on cellular phones on the way to power lunches. See Christopher Marquis, "Cuba set to stop bribes, kickbacks." Haroldo Dilla, sociologist at the Havana *Centro de Estudios de América* cites a study of the *Instituto Nacional de Investigación Económica*, which has detected the seeds of the new "fortunes": "...the accumulation of capital in few hands is already a reality. ... [T]he main beneficiaries of the economic adjustment have been the '*macetas,*' a type of mafia with the pretension of becoming bourgeoisie. They are leading the concentration observed in the area of self-employment and free markets. ... [A] free market in Havana in theory has 22 independent vendors. In reality, the vendors are controlled by three individuals who provide them supplies and pay them a salary, even though this is forbidden by the Cuban Constitution." Quoted in Marquis, "Cuba set to stop bribes, kickbacks."

208. Jorge A. Sanguinetty, "Economic education for a market economy: the Cuban case," *Cuba in Transition—Volume 5* (Washington: Association for the Study of the Cuban Economy, 1995).

a striking lesson.[209]) The negative impact on morale results in the perception by the population of the nature of private property as predatory (reinforced by decades of Marxist education and rhetoric), which can actually hinder the eventual and peaceful adoption of a free market democracy.[210]

Furthermore, the enclave system of foreign joint ventures—captive to the leadership, concessionary to foreigners and the ruling elite, and lacking transparency and competitiveness- is contrary to the conceptual configuration of capitalism. As conceived by Adam Smith, capitalism thrives only when restrained by a system of values and a panoply institutions which allow the market to unleash forces of progress while controlling its worst consequences. Cuba's system poses an intrinsic philosophical negation of the theoretical foundation of the capitalism that has been successful—or at least viable—in Western societies.[211] A political constraint inherent to preserving Cuba's current system prevents meaningful socio-economic and political empowerment and forestalls the release of those forces which can generate economic recovery/viability/prosperity in a proper framework and a climate of internal peace. In its present form, foreign investment in Cuba is not helping release those forces, but rather appears to assist in their containment.

### 3. Economic determinism and political reform[212]

Part of the problem in interpreting Cuba's reform process may have to do with the marked contrast between what the government portrays to the outside world compared to what it says and does inside Cuba. To the world, Cuba has depicted its process of liberalization as "working towards an 'achievable utopia' where socialism has adapted to new world conditions with some market elements, but the state retains a key role. In September 1995 the Cuban Foreign Minister, Roberto Robaina, courted the U.S. business community with the concept that Cuba is on it's way to developing "a new and unique model," where political reform is "not excluded."[213] Visiting New York city again in September 1996, he reiterated that Cuba was searching for its own peculiar model and requested patience and understanding.[214] Minister Lage declared in August 1996: "Cuba has taken its own steps without mechanically copying other ex-

209. In Russia, amidst reports of a mafia-type anarchy, former government officials now control most of the shares of huge former state conglomerates and companies that were privatized in a process marred by official corruption, bribery, favoritism, and criminal acts. "Money that was supposed to jump-start the private sector has instead enriched the old Communist ruling class. ... As the average citizen lost his stake in Russia, former Communists, who make up less than ten percent of the population, prospered. ... [N]early two-thirds of the country's millionaires had been members of the Soviet Communist Party. The KGB too has profited." J. Michael Waller, "To Russia with cash," *Readers Digest* (June 1996).

210. For example, the editor of *The New Republic* illustrates the dynamics behind a Canadian investment: "Sherritt's example, and that of other Canadians who do business in Cuba, shows that these foreign operations are a caricature of competitive capitalism. Their impact is anything but subversive. ...When Canadian investors come to Havana, they don't shop around for partners amount the Cuban populace at large; the average Cuban can't own private property, much less engage in ventures with foreigners. All deals are negotiated with the government, often with Fidel personally. No competitive bids, no international tender offers in *The Economist*, just a nod from the man in charge..." Lane, "Canada Sly."

211. The thread that runs through Adam Smith's writings on Capitalism is the imperative to design institutions which draw "the passions" towards socially and morally beneficial behavior. Smith believed that commercial society made it possible for the mass of the people to escape the demeaning relations of dependence characteristic of the past. Direct domination by political elites would be replaced by a network of institutions which promoted self-control among politically free citizens and raised the level of material comfort to make possible the expansion of sympathy and concern for others. See, for example, Jerry Z. Muller*, Adam Smith in his time and ours: Designing the decent society* (New York: The Free Press, 1993).

212. An analysis of the concept and debate on economic determinism—the notion that economic development is a natural precursor to political development—has been left out but is incorporated in the full version of this paper.

213. Roberto Robaina, "Cuba & the United States: Is there room for dialogue?," The New York Hilton, September 28, 1994. Notes taken by the author, who was in attendance.

214. The Minister spoke at a luncheon hosted by the *U.S.-Cuba Trade and Economic Council,* New York, September 26, 1996. As per anecdotal account to the author by an attendee.

periences... assimilating all useful practices which can be taken into account in the closest relation with the world while constructing our own socialist path."[215] This sort of discourse characterizes the prevailing theme for external consumption; it provides an eerie allusion of Lenin's mastery of distortion to advance Communist ends through capitalist means.[216] In August of 1995 the President of the State and Ministerial Councils clearly stated the government's intentions:

> "during many years we fought against foreign investment... however, in the current situation we could not do without foreign investment at a higher level, because we needed capital, technology and markets.... we took this path because this was the only alternative ... the key of all this is the issue of power. Who has the power? That is the key.... Transition to capitalism? There will be no transition to capitalism."[217]

For those who can read between the lines and carefully follow what is said by the Cuban leadership, its commitment to avoiding reform, both in words and in practice, is consistent. It is all too clear that economic liberalization is not enticing the ruling elite towards structural economic reform or political reform of any sort, as it is well aware of the threats reforms convey.[218] Internally, the government has consistently justified the changes on the economic front as necessary evils to secure economic survival without a loosening of political control. (This is typically packaged as the "need to preserve the 'achievements' of the Revolution.") Its leadership has repeatedly confirmed its resolve to defend the political status quo despite the adoption of certain elements of "the Chinese model"—that is, to preserve the Revolution, whatever it still represents today, the Marxist-Leninist ideology, and the Socialist economic system. Moreover, Castro continues to decry capitalism and has declared emphatically that Cuba cannot take the risk of repeating the mistakes of the former Soviet bloc and has intoned: "The island will sink into the sea before it stops being Communist."[219]

In the final analysis, assumptions and vague generalizations on Cuba's reform process have to be tested with reality. To this day causality has not occurred nor been proven certain. Perhaps the most telling measure of engagement's outcome is that it has failed to produce tangible payoffs despite Cuba's normal commercial and political relations of many years with most countries. Even the countries with most influ-

215. *Negocios en Cuba*, op.cit., p. 7.

216. Lenin spent most of his life at the epicenter of an international conspiracy predicated on the idea that an entire world order -capitalism- could be subverted and overthrown by a small cadre of professional conspirators who would bring about world revolution. "Its success would proceed from secrecy, discipline, and deception. The real would be hidden, the false displayed. Opponents would be confused, diverted, and ultimately misled into collaborating in their own destruction." Edward Jay Epstein, *Dossier: The Secret History of Armand Hammer* (New York: Random House, 1996), pp. 58-59. Lenin was convinced that the Communists did not know how to run the economy. His report for the XIth Party Congress of April 1922, states: "The capitalists ...know how to do things. ... The mixed companies that we have begun to form, in which private capitalists, Russian and foreign, and Communists participate, provide one of the means by which we can learn to organize competition properly." Robert C. Tucker, ed., *The Lenin Anthology* (New York: W. W. Norton & Company, Inc., 1975). In 1921 Lenin masterminded the *Trust Operation*, labeled "one of the most elaborate deceptions in modern history." Designed to make Western governments believe they could achieve the overthrow of Communism by giving up their economic sanctions, its ultimate objective was to obtain help from abroad—spare parts, trucks, etc.—to help Russia survive a desperate economic crisis. It achieved its goal by passing along to Western intelligence misinformation through a Russian organization controlled by Cheek agents masquerading as anti-Communist. Portraying Lenin's' economic reforms as signaling the eventual abandonment of Communism, it convinced the West that what kept the Bolsheviks in power was Russian antipathy for foreign subversion. Lenin "had to do whatever was necessary to advance the image of a non-threatening Russia—even when the measures deviated from, or contradicted, Marxist ideology. *The end still justified the means where the survival of the revolution was at stake."* Epstein, *Dossier: The Secret History of Armand Hammer*, pp. 62-63.

217. Speech delivered at the closing ceremonies of a Youth Festival. See *Boletin del ICEI* (enero-febrero 1996), p. 7.

218. Professor Gunn of Georgetown University had explained in early 1993: "Castro has given considerable thought to the ideological "contamination" inherent in collaboration with foreign capitalist enterprises ...and has concluded that despite the risks, Cuba has no choice but to welcome investment." See Gunn, "The Sociological Impact of Rising Foreign Investment," p. 2.

219. Montaner, "The risks...."

ence have declared their failure and frustration. As proof of the leaderships' determination and its effectiveness in containing reform, the Executive Director of Human Rights Watch recently concluded: "...any improvement in the island's economy which may have resulted from the arrival of European investment has not been matched by any greater opportunity for civil society."[220]

Mechanisms of control operate and remain effective at all levels. The U.N. Special Rapporteur for Cuba continues to report "serious violations of civil and political rights."[221] Information remains "exclusive state property" and international journalists' organizations have denounced widespread attacks against Cuban journalists who have in recent years formed the first independent news agencies in socialist Cuba.[222] The government's resolve and enforcement capabilities are demonstrated by the emergence of sophisticated tactics of repression to counter potential erosions of control emanating from the economic crisis and the measures designed to confront it. A mid-1994 broad reform of the Penal Code toughened the laws for economic crimes amidst a crackdown on "abuses of economic reforms" tied to the legalization of small-scale private businesses.[223] New forms of institutionalized violence based on popular mobilization have been unleashed against those who call for change.[224] To break down the growing internal opposition without provoking a worldwide outcry, dissidents are being habitually harassed and pressured to leave the country in lieu of the long jail terms of the past. Aside from the mechanisms of control embodied in the Foreign Investment Law, specific measures have been taken in the foreign sector to curtail the emergence of an empowered second economy: 1) pre-screening the applicant pool of workers for "revolutionary behavior"; 2) targeting workforce reductions at employees of certain political views and subjecting those who complain to "Actos de Repudio"; 3) passing especially strict regulations for tourism workers, as discussed above; 4) requiring that hotel management commissions have a representative from the Communist Party, the Union of Young Communists and the government controlled workers' union, CTC; 5) giving emulation prizes to those performing voluntary labor and paying union dues; and 6) subjecting workers in the tourism industry to "forced voluntary labor."

Within the context of Cuba's liberalizing measures and its opening to foreign investment, the question of external-sector generated influence or pressure for reform should not miss the crucial point. With respect to Cuba, as with other totalitarian systems, the root issue is: if it does, how can it, or will it, actually lead to change? A factor that compounds the dilemma and contradicts the workability of the cause-effect dynamic must be considered: if reforms bring relief, they could actually discourage the need for more reform; if economic pressure diminishes on a leadership bent on self-preservation, the need to take such a high risk can be eliminated. Indeed, the following argument has been put forth: "In fact, foreign investment has been used as a means to avoid or postpone unavoidable and necessary changes, rather than acting as an agent in support of reforms."[225]

Particularly, in the aftermath of the February 1996 forceful crackdown on the internal dissident move-

220. José M. Vivanco, *European Voice* (19-25 September 1996), p. 14.

221. See, for example, Anthony Goodman, "U.N. says serious violations continue in Cuba," *Reuters Wire Service* (November 15, 1995).

222. *Committee to Protect Journalists*, News Advisory (July, 25, 1995).

223. John Rice, "Cuba toughens laws for economic crimes, illegal demonstrations," *The San Juan Star* (July 4, 1994); and Kenneth Feed, "Impredecible la situación de Cuba, *El Nuevo Día* (5 de diciembre de 1994).

224. Such as Rapid Response Brigades (*Brigadas de Acción Rápida*)—paramilitary groups ready for immediate action—and Popular Acts of Repudiation (*Actos de Repudio*)—the shouting of insults by a mob, often accompanied by the painting of derogatory slogans on victims' properties and, in some cases, entry into their homes and destruction of their belongings; reports of attacks on the victims and/or their families have also been received.

225. Castañeda, and Montalván, "The Arcos Principles."

ment and the downing of two civilian planes of a Cuban-American group, reform in Cuba seems a distant illusion as the leadership's priorities have been forcefully reasserted.[226] This was further confirmed by Raúl Castro's speech of March 1996, which delivered a forceful blow to moderates and reformists within the leadership,[227] and the July 1996 enactment of a Code of Ethics for Party Members.[228] As a result, it looks like little change can be expected short of a dramatic and unexpected turn of events. The people do not have any means to organize an effective opposition movement and are too busy trying to figure out how to get their next meal. The semi-organized dissident movement continues committed solely to peaceful change and has been kept fragmented and repressed by State Security. With the pervasive control of State Security, in allegiance with and dependent on regime survival, it is unlikely that the population, no matter how much it is influenced by market forces, will attain any capacity to demand or impose change.

In this scenario, it seems improbable that foreign investment/commercial engagement—especially with its relatively low significance in the Cuban economy—could foster actual reform. Given the depths of the economic and social crisis that Cuba has already endured without an aftermath of consequence, it seems very improbable that any further internal discontent will make a difference. This was poignantly proven when the regime abandoned Communist orthodoxy, which entailed an enormous loss of legitimacy. All the emerging and powerful contradictions to the egalitarian socialist ethos—the debacle on the ideological front, the shocking economic failure of the socialist model, the blatant inequalities of selective capitalism, and the severe hardships that have befallen the population—have not been able to generate a change in the repressive nature of the regime. As long as the regime retains the means of control, the instruments of legitimization can be manipulated.

Because in Cuba power is strongly centralized and forcefully exercised, and decision-making is very vertical, market forces, which operate spontaneously and in a decentralized manner, are inherently constrained. This negates the main theoretical argument for engagement and renders it essentially flawed at the core. Foreign investment in Cuba is, in essence, hostage to the prevailing dialectic. A recent analysis on China concludes that economic engagement has also failed to bring about political moderation and a modicum of pluralism there because the three elements that would foster reform—the rule of law, political accountability and a free press—challenge the security of the regime and are, thus, banned. A prominent scholar on Asia declares: "If China is permitted to merely pick and choose which aspects of integration it finds palatable, and to resist those that push change in the direction of moderation and plualism, them the time scale required by economic engagement will stretch toward infinity."[229] The same selective approach to capitalist mechanisms is the one applied by the Cuban leadership, and it has been effective. A systematically repressive apparatus appears

226. On February 24, 1996 the Cuban government downed two small and unarmed civilian aircraft belonging to *Brothers to the Rescue*, a volunteer organization which for years has carried on humanitarian flights to identify and assist Cuban rafters. Castro acknowledged giving the order to shoot the planes down and the Cuban government alleged the aircraft were operating in Cuban airspace. Witnesses and the U.S. government insist they were flying in international airspace and an international aviation body established that the aircraft were shot down over international waters. The incident came in the wake of a ten day crackdown on *Concilio Cubano* delegates, an umbrella organization of peaceful dissident groups which had requested government permission to hold their first national assembly on the day of the shoot down.

227. Raúl Castro, head of the Cuban Armed Forces, called Communist Party-affiliated study centers "scant elements of internal opposition ... a *de facto* natural ally of the counter-revolution ... caught in the spider's web spun by foreign specialists on Cuba, who are really working for the United States and its strategy to create a fifth column." Raúl Castro Ruz, "Maintaining Revolutionary Purity," report presented by the General of the Army to the Central Committee of the Communist party of Cuba, March 23, 1996, in *Cuba: political pilgrims and cultural wars* (Washington: The Free Cuba Center of Freedom House, 1996).

228. "Aprobado el código de ética de los cuadros del estado cubano," *Granma* (16 de julio de 1996).

229. Shinn, "Engaging China: exploiting the fissures in the facade."

to have tremendous impact on the feasibility and timing of political change regardless of economic reform. The Cuban people simply do not possess the means to exercise self-determination. When the leadership is committed to survival at all costs, regime legitimization is not the issue; the issue is capacity to exercise control.

### 4. Commercial engagement's impact on policy formulation

Commercial engagement generates the creation of vested business interests rationally bent on self-preservation. Because business concerns tend to have ample financial resources at their disposal, they can secure considerable political clout with relative ease. Therefore, the risk that decision-making will be tilted in their favor is apt to be high.

In looking to advance their standing, business concerns will naturally look to override those objectives which prove irreconcilable to their goals. For instance, prominent proponents in the United States of commercial engagement with Cuba claim detachment to non-business concerns.[230] John Kavulich, President of the U.S. Cuba Trade and Economic Council has stated: "With our focus being informational, politics doesn't come up."[231]Even the savviest investors have failed to establish creditable reputations in influencing the design of sound foreign policy. In the pursuit of attractive profits, business concerns have historically engaged in decision-making that has overlooked considerable risks and even ultimately hurt their own best interests, sometimes with devastating consequences spilling over to many other areas. Many historic financial crises have demonstrated that overzealous and negligent cross-border profit-seeking has been painfully common, which is particularly eye-opening given the higher level of sophistication expected of the financial industry.[232] Drawing a parallel with equity investments in underdeveloped and high-risk countries such as Cuba, investors are likely to be assuming unmitigated risks which could lead to their exertion of undue influence in the foreign policies of their home governments.

Cuba, in fact, already offers a prime example of capitalists' naiveté.[233] In the early sixties, the revolutionary government repudiated Cuba's international financial obligations and confiscated all foreign properties in the island,[234] yet in less than two decades it had regained access to foreign credit.[235] By 1982 Cuba could not meet its financial obligations and in 1986 it walked out of negotiation talks with the Paris Club. To this day its hard currency debt is in default and its government refuses to enter into reprogramming programs. During the 1980's interna-

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230. Trevor Armbrister, "Fawning over Fidel," *Readers Digest* (May 1996), p.150.

231. Armbrister, "Fawning over Fidel," p. 149. The powerful Chairman of ADM, Dwayne Andreas, questioned about Castro's human rights record, responded: "I don't think about that. ...That's for the politicians to worry about." Quoted in Armbrister, "Fawning over Fidel," p. 149.

232. A study of the financial industry is particularly relevant because the element of risk is intrinsic to this business. It is well documented that in the last two centuries U.S. banks and institutional and private investors have overlooked risks in assessing international lending and investment opportunities which at one time they considered highly profitable. The added difficulties of accurately assessing cross-border risks are compounded by the vulnerability and imperfections of the international financial system. The author's Masters' thesis dealt with the 1980's international debt crisis and analyzed commercial bank lending and financial crisis in Latin America since its independence. See María C. Werlau, *Los bancos comerciales internacionales y la crisis de deuda externa en América Latina: una perspectiva histórica a la luz de la crisis de los ochenta* (Santiago: Universidad de Chile, Instituto de Estudios Internacionales, 1995.)

233. In fact, in the early 1920's Lenin, looking to secure the economic survival of Russia, bet that "the capitalists' presumed greed could be used to the Soviet advantage concessions to foreign capitalists were part of Lenin's strategy—the 'bait' to help overcome the political hostility of businessmen, who, looking to obtain better terms vis-à-vis their competitors, would pressure their respective governments to lift restrictions" on trade. See Epstein, *Dossier: The Secret History of Armand Hammer,* p. 59.

234. As discussed above, upon assuming power in 1959, Castro's revolutionary government declared a radical repudiation of the international financial obligations of previous Cuban governments and ordered the expropriation of foreign property in Cuba.

235. While the embargo precluded U.S. banks from doing business in Cuba, European, Japanese, Canadian, and Arab commercial banks made voluminous loans to Cuba starting in the second half of the seventies. At the time Cuba came to be regarded as an "attractive borrower" based on credit risk analyses which disregarded very high risk factors. See Werlau, *Los bancos comerciales internacionales.*

tional debt crisis, Castro even attempted to form a debtor's cartel to repudiate debts.

A reductionist application of the logic of commercial engagement could tilt policy-making in favor of narrow, short-term, business considerations which hinder the development of foreign policies based on a balanced convergence of interests which address the overall long-term economic development and political stability of Cuba. That, in essence, is what can provide lasting opportunities for business and converges with the interests of the international community as a whole.

## CONCLUSION

Commercial engagement is often brandished as the appropriate foundation for foreign policies towards Cuba—the ultimate solution to "the Cuba problem." But, as we have seen, conditions and characteristics unique to Cuba inhibit the workability of this rationale. Foreign investment has failed to, in its present context, bring about economic recovery and political/economic reform because Cuba' business climate cannot attract a meaningful level of investment and because it operates within a framework which inherently restrains its reform-inducing forces. As a result, in its present form, it is primarily a tool of regime survival. For commercial engagement to work it would have to advance the very practices that threaten regime survival, i.e. become a tool of "conditional engagement."

The severity of Cuba's crisis makes the adoption of market-enabling policies within a proper legal framework imperative to foster an economic recovery. This, in turn, would enable the forces of economic and political empowerment to operate. In the area of foreign investment, liberalization would require, among others, providing access to the domestic market, allowing Cuban citizens ownership of joint ventures, and eliminating wage confiscation and State control over workers. Yet, the single most important element to achieve economic growth and social empowerment seems to be the continued liberalization of self-employment within a context of an emerging private sector.[236] Nevertheless, it is likely that the ruling elite will continue to prevent changes in the system that will provoke its own demise through the loss of State control, no matter what economic gains they may propitiate. Thus, the political imperatives of a regime with the means to impose power by force will likely preclude economic and political development and will continue to dictate the terms of foreign investment and commercial engagement in Cuba.

Formulism[237] and reductionism, often present in policy debates about Cuba, are dangerous instruments of policy manipulation. The quality of the debate on Cuba would greatly benefit if the limits of commercial engagement as a policy prescription are acknowledged and our expectations adjusted accordingly. Cuba's predicament precludes simple answers. Responsible, comprehensive, and effective policy-making must seek to balance a convergence of interests: geostrategic/national security, economic, political, and ethical. In the final analysis, however, we are compelled to recognize that Cuba's problems are more complex and profound than resolving the issue of whether or not commercial engagement or foreign investment are suitable instruments of foreign policy to foster reform. Ultimately, neither pressure nor engagement may be capable of bringing about the desired democratization and economic viability of Cuba; these may remain primarily dependent on internal circumstances.

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236. It would allow the absorption of the large number of unemployed. The current numbers of self-employed, said to be around 200,000, puts a very minor dent in the pool of over one million estimated to be unemployed, even worse if one takes into accounts reports that only approximately 30 percent of the self-employed were formerly employed, the balance made up of people holding other jobs, some pensioners and former housewives. But, the current framework would also need reform, as self-employment has already stimulated a series of problems: corruption, the sale of stolen goods or goods manufactured with inputs stolen from state enterprises, the accumulation of wealth in the hands of a few, and tax evasion (estimated at around 40 percent).

237. As described by Stanley Hoffman, formulism is "a desire to reduce complicated realities to fixed formulae and analogies, to short-hand, and/or sum up complexities in slogans and solutions." In V. Vaky, "Political change in Latin America: A foreign policy dilemma for the United States," *Journal of Interamerican Studies and World Affairs*, Vol.28, No.2 (Summer 1986).