INVESTMENT INCENTIVES OF THE ZED MARIEL: WILL FOREIGN INVESTORS TAKE THE BAIT?

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On September 19, 2013, Cuban Council of State President Raúl Castro signed Law-Decree No. 313, establishing the Mariel Special Development Zone (Zona Especial de Desarrollo del Mariel, ZEDM). A few days later, on September 23, 2013, Cuba's *Gaceta Oficial* published the text of the Law-Decree together with implementing regulations issued by the Council of State, the Cuban Central Bank, the General Customs, and the Ministries of Science, Technology and the Environment, Finance and Prices, Interior, and Labor and Social Security.[1]

The formal establishment of the ZEDM, coupled with other recent developments regarding foreign investment—e.g., the launch of a major project to modernize the port of Mariel and the buzz about the passage in March 2014 of a much-anticipated comprehensive foreign investment law—have given Cuban officials an opening to aggressively pitch the benefits of investing in the island. For example, at the XXX Havana International Fair held in early November 2013, Minister of Foreign Investment and Foreign Trade Rodrigo Malmierca, described the newly-established ZEDM as presenting "a new opportunity for foreign investment as part of the updating of the country's economic model"; Minister Malmierca highlighted some of the economic advantages of the ZEDM, among them "full protection and security of investors and authorization for the free transfer of financial resources and profits abroad without additional taxes or surcharges."[2]

The aim of this paper is to describe and analyze, in a comparative framework, the set of investment incentives that Cuba offers foreign investors that locate in the ZEDM. The paper discusses briefly the historical development of export processing zones or similar entities to attract foreign investment globally and then Cuba's prior experiences with such efforts. It concludes with some observations about the ZEDM in the context of similar arrangements in the Caribbean and Central America.

HISTORICAL DEVELOPMENT OF EXPORT PROCESSING ZONES

Export processing zones (EPZs) are enclaves within a national customs territory into which foreign capital goods, components and materials can be brought in duty-free.[3] Host governments generally grant fiscal and other incentives to companies that locate in these

1. The text of Law-Decree No. 313 and related decrees and resolutions were published in *Gaceta Oficial*, No. 26, Extraordinaria (September 23, 2013), pp. 205–235. The Law-Decree and regulations became effective on November 1, 2013.

2. "Cuba promotes Mariel Special Development Zone," *Cuba Contemporanea* (November 6, 2013), http://www.cubacontemporanea.com/en/print7661.

3. The working definition of EPZs in this paragraph is taken from Gregory K. Schoepfle and Jorge F. Pérez-López, "Export Assembly Operations in Mexico and the Caribbean," *Journal of Interamerican Studies and World Affairs*, 31:4 (Winter 1989), pp. 132–133. The discussion that follows about EPZs in the Caribbean region also draws from this source. See also, World Bank, "Export Processing Zones," *PREMNotes* (December 1998).

Box 1. Types of Export-Oriented Zones

Export processing zones (EPZs) are industrial estates aimed primarily at foreign markets. Hybrid EPZs are typically sub-divided into a general zone open to all industries and a separate EPZ area reserved for export-oriented, EPZ-registered enterprises.

Special economic zones (SEZs) are geographically delimited areas administered by a single body, offering certain incentives (generally duty-free importing and streamlined customs procedures, for instance) to businesses which physically locate within the zone. Cuba's special development zones may be considered a form of SEZ.

Free trade zones (FTZs; also known as commercial free zones) are fenced-in, duty-free areas, offering warehousing, storage, and distribution facilities for trade, transshipment, and re-export operations.

Enterprise zones (EZs) are intended to revitalize distressed urban or rural areas through the provision of tax incentives and financial grants.

Freeports typically encompass much larger areas. They accommodate all types of activities, including tourism and retail sales, permit on-site residence, and provide a broader set of incentives and benefits.

Single factory EPZ schemes provide incentives to individual enterprises regardless of location; factories do not have to locate within a designated zone to receive incentives and privileges. Single factory EPZ programs are similar to bonded manufacturing warehouse schemes, although they typically offer a broader set of benefits and more flexible controls.

Specialized zones include science/technology parks, petrochemical zones, logistics parks, import-based zones, and so on.

Source: World Bank, *Special Economic Zones: Performance, Implications and Lessons Learned for Zone Development* (Washington: World Bank, 2008), p. 3 and author's additions.

enclaves. Imported components and materials are processed within EPZs—typically, they are assembled into a finished product—and then exported. Custom duties are not assessed on the imported components unless the finished product enters the national customs territory of the host country (i.e., the good is consumed within the host economy). The basic premises underlying EPZs, namely duty-free importation of equipment and materials and a variety of incentives to attract foreign investors, are also present in other forms of export-oriented activities with different names (see Box 1) that are not necessarily located in an enclave industrial park, special economic zone or customs in-bond territory.

Among the earliest, and most developed, forms of EPZs in the Western Hemisphere are the Mexican *maquiladoras*, established in that country beginning in 1965 within a 20-kilometer strip along the Mexico-United States border. Plants established within this geographic zone could import in-bond (i.e., without paying duty) foreign-made components or metal products to be assembled or further processed in Mexico and then exported (typically to the United States). Similarly, imported machinery, equipment, raw materials, replacement parts, tools and accessories used by these plants in production for export were subject to temporary duty-free entry. In the early 1970s, Mexico relaxed the restriction that *maquiladoras* locate in the U.S. border region in the interest of development of other regions of the nation, although *maquiladoras* still concentrate near the U.S. border.

In the late 1960s and early 1970s, many Caribbean Basin countries enacted legislation that created the conditions for the establishment of export-oriented assembly operations in their territories. They established the facilities in urban areas, near an international port and/or airport. The locations took advantage of existing transportation infrastructure to import machinery and materials for assembly and the export of finished goods. Examples of early EPZ of the enclave type in the region include La Romana in the Dominican Republic (established in 1969), San Bartolo in El Salvador (1974), and Puerto Cortés in Honduras (1974); Haiti, Costa Rica, and Guatemala meanwhile enacted legislation extending customs and investment incentives to export-oriented plants irrespective of where they were located in the nation.

In December 1978, the Chinese Communist Party adopted a set of comprehensive economic reforms generally known as "Socialism with Chinese Characteristics." A key component was the opening of the economy to foreign trade and investment. Initially, the policy vis-a-vis foreign direct investment (FDI) was limited to a readiness to welcome Sino-foreign joint ventures, with an emphasis on factories established by overseas Chinese and foreign citizens of Chinese origin.[4] A very significant development in the implementation of the opening to foreign investment was the decision by the Chinese government in 1980 to establish four Special Economic Zones (SEZ) in Shenzhen, Zhuhai, Shantou and Xiamen in Guangdong and Fujian provinces.[5] The objective of the SEZs was to: (1) attract foreign capital; (2) introduce advanced technology and management expertise; and (3) pilot market-oriented reforms in preparation for implementing the reform and opening up program nationwide. The four areas were chosen as laboratories for China's foreign economic opening because of their proximity to Hong Kong, Macao, Taiwan and Southeast Asia and their anticipated ability to serve as a channel to attract overseas Chinese capital into China.

Based on the success of the original SEZs, in 1984, China opened 14 coastal port cities to foreign investment and established economic and technical development zones (ETDZ) to draw foreign industrial investment. The following year, the Chinese government opened the Yangtze River Delta, the Pearl River Delta and the Xiamen-Zhangzhou-Quanzhou Delta as costal zones (CZ) open to foreign investment. This decision signaled that China was ready to accept foreign investment in entire areas of the country rather than individual cities. China has progressively reduced barriers to foreign investment, eagerly accepting foreign owned investment and essentially opening the entire nation and all sectors of the economy to FDI. By the late 1980s-early 1990s, China was by far the largest destination of foreign investment flows among developing countries.[6]

There are no up-to-date statistics on the number of countries that host EPZs or the number of EPZs in operation globally. However:

- A study on trade and labor standards published by the OECD in 1996 references the existence at that time of 500 zones located in 73 countries.[7]
- The International Labor Organization (ILO) estimated that at the end of 2002, there were 3,000 EPZs in 116 countries, employing some 43 million workers.[8]
- A document on the website of the World Export Processing Zone Association (WEPZA), proba-

4. Organization for Economic Cooperation and Development (OECD), *OECD Investment Policy Review: China 2003: Progress and Reform Challenges* (Paris: OECD, 2003), p. 30.

5. *Major Investment Areas in China*, a report compiled by the Department of Special Zones of the State Council Office for Economic Restructuring, P.R.C. (Beijing: China Intercontinental Press, 1999), p. 6.

6. See statistics in United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 1993* (Geneva, UNCTAD, 1993).

7. Organization for Economic Cooperation and Development, *Trade, Employment and Labour Standards* (Paris: OECD, 1996), p. 99, citing an unpublished report by P. Lloyd.

8. *Employment and social policy in respect of export processing zones (EPZs)*, ILO Governing Body, 286th Session, March 2003, p. 2.

bly dating from the early 2000s, lists 132 countries that hosted EPZs.[9]

- A logistics/supply chain website company reports that in 2006, 130 countries had established over 3,500 EPZs within their borders, with an estimated 66 million workers employed in those EPZs; while some EPZs are single factory locations, others, such as the Chinese SEZs, are so large that they have resident populations.[10]
- A World Bank publication estimated that in 2008, there were approximately 3,000 zones in 135 countries, accounting for over 68 million direct jobs and over $500 billion of direct trade-related value added within zones.[11]

CUBA'S PRIOR EXPERIENCE WITH EPZs

In the current barrage of press coverage and statements by Cuban officials promoting the ZEDM, previous efforts to establish EPZs in the island have been glossed over. It is worth recalling that Chapter XV of the legal framework for foreign investment in effect from 1995 until March 2014, namely Law No. 77/95 of 1995, already provided for the possibility of establishing "free trade zones and industrial parks."[12] Such free trade zones and industrial parks, created for the purpose of stimulating exports and foreign trade, would:

- have to be established in specific areas of the nation (Article 50);
- be subject to special rules and regulations to be issued by the Executive Committee of the Council of Ministers regarding customs, taxation, labor, capital investment and foreign trade (in addition, for free trade zones, special rules regarding migration, currency exchange and public order) (Article 51); and
- be subject to the specific incentives set out in the authorization for investment issued by the Executive Committee of the Council of Ministers.

In early June 1996, the Council of State approved Decree-Law No. 165, which promulgated regulations for free trade zones and industrial parks.[13] In May 1997, then Minister of Foreign Investment Ibrahim Ferradaz announced the opening of the Wajay Free Trade Zone, located near La Habana's International Airport; two other duty-free zones were established in Berroa (east of La Habana) also in May 1997 and in the port of Mariel (about 26 miles West of La Habana) in November 1997.[14] The first investment in the Wajay zone, according to Ferradaz, was by a Jamaican maker of instant soft drinks, working with British capital. According to another source, at about the same time, licenses to operate in the new Cuban free trade zones had been granted to a Canadian producer of construction materials, an Italian pasta-maker as well as several Spanish companies.[15] A Cuban website intended to promote incoming foreign investment stated that in May 2000, "there are 237 operators [i.e., investors] ... [in the zones] ... and

9. http://www.wepza.org/. Included are countries that hosted large zones (areas with a resident population, such as the Chinese SEZs or cities designated as hosts for FDI), small zones (typically smaller than 1000 hectares, with no resident population, although worker dormitories may be allowed; investors must locate within the zone to receive benefits); industry-specific zones (such as jewelry zones in India or offshore banking zones); and performance-specific zones (which can be established anywhere in a country provided they meet certain criteria, such as export targets, level of technology, size of investment).

10. http://logistics.about.com/od/supplychainintroduction/a/Export-Processing-Zones-epz.htm

11. World Bank, *Special Economic Zones: Performance, Implications and Lessons Learned for Zone Development* (Washington: World Bank, 2008), p. 7.

12. Capítulo XV, Del Régimen de Zonas Francas y de Parques Industriales, Ley No. 77/95.

13. Decreto-Ley de Zonas Francas y Parques Industriales (June 2, 1996), http://www.cuba.cu/negocios/DL165.htm.

14. "Cuba Opens First of Four Duty-Free Zones," AP (May 6, 1997). A fourth duty-free zone, to be located near the port of Cienfuegos, in Cuba's southern coast, was also announced, but there is no evidence that it was actually established. The regulations for the Mariel Free Zone were approved by the Council of Ministers on October 23, 1997and published in the *Gaceta Oficial* on November 13, 1997.

15. Marc M. Harris, "Cuban Free Trade Zones," 1977, http://cubaninvesting.tripod.com/cubantradezones.html

more than 23 are awaiting approval. Many more are still at the negotiation stage."[16]

Systematic information on the performance of the free trade zones, in terms of the number of operators (investors), the value of investments, the nature of the operations or their contribution to exports are not available. Whatever information does exist is difficult to interpret because of obscure definitions and changes in institutional arrangements. For example, Cuban economist Pérez Villanueva writes:

> Even before the free-trade zones were inaugurated, there were already 80 commercial operators in Havana in Bond and Almacenes Universales in Wajay; once the free trade zones were created, the license under which these entities operated was changed and they became free-trade zone operators. In 1999, there were 243 free trade zone operators, of which 65% or 160 were engaged in commercial activities; considering that 80 such operators already existed, the net increase in commercial operators is 80. After the zones were created, 34 productive enterprises have located in them and some are in technological areas, such as software development, industrial projects, and machinery.[17]

Pérez Villanueva further states that in 1999, there were 120 operators in the Wajay zone, 91 in Berroa and 32 in Mariel and that the top five countries of origin for zone operators were Spain (62), Panama (43), Italy (33), Canada (13) and Mexico (13). He points out that the very high number of operators from Panama suggests that they were probably engaged in commercial activities, a field in which Panamanian companies that have operated in the free trade zones in their own country had gathered experience.

Based on statistics from the Cuban Ministry of Foreign Investment (MINVEC), Spadoni reported the following number of operators in free trade zones and value of exports (million pesos) for 1997–2003: 1997, 34 operators and exports of $0.3 million; 1998, 171 and $3.5 million; 1999, 324 and $9.3 million; 2000, 354 and $22.0 million; 2001, 326 and $26.3 million; 2002, 319 and $59.9 million; and 2003, 284 (no information on exports).[18] On their face, these figures appear positive. Yet, according to Pérez Villanueva, although "most of the companies were productive and provided advantages in job generation and technology acquisition, their performance for various reasons have not reached the levels targeted in the original proposals."[19] Spadoni reports that already in 2001, Cuban authorities investigated the activities of 111 operators and "revoked licenses to 90% of them, mainly because of poor economic results, violations of established rules for the movement of goods and delays in the recruitment of Cuban workers. [In 2002] ... no authorizations were granted for new activities in FTZs and 35 firms had their licenses revoked. By the end of 2003, only 284 operators remained in Cuba's free trade zones."[20] He concludes:

> Cuba's experience with foreign investment in free trade zones has been unsuccessful. ... Cuba was unable to attract major international companies into its FTZs, the amount of invested capital was relatively small and limited to low-technology sectors with little economic impact, and only a small percentage of operators performed manufacturing activities. It was therefore no surprise when the Castro government announced in 2004 that it would stop promoting the development of free trade zones in

16. http://www.commerceincuba.com/english/zonas.asp

17. Omar Everleny Pérez Villanueva, " La inversión extranjera directa en Cuba. Peculiaridades," 1999, http://www.nodo50.org/cubasigloXXI/economia/villanueva2_300602.htm.

18. Paolo Spadoni, "The Current Situation of Foreign Investment in Cuba," *Cuba in Transition—Volume 14* (Washington: Association for the Study of the Cuban Economy, 2004), p. 133.

19. Omar Everleny Pérez Villanueva, "The Role of Foreign Direct Investment in Economic Development: The Cuban Experience," in Jorge I. Domínguez, Omar Everleny Pérez Villanueva and Lorena Barberia, *The Cuban Economy at the Start of the Twenty-First Century* (Cambridge: Harvard University Press, 2004), p. 192.

20. Spadoni, "The Current Situation of Foreign Investment in Cuba," p. 133.

> the island and give existing operators a period of three years to find other business options in Cuba.[21]

In a harsh assessment of the free trade zones, international EPZ expert Willmore concluded in the late 1990s that "Cuba's EPZ strategy has failed and will continue to fail not because of the external [U.S.] embargo, but rather because of Cuba's own internal policies, which (1) do not allow foreign companies to hire workers directly and, most importantly, (2) impose a high implicit tax on wages."[22] More recently, Feinberg has referred to the creation of free trade zones pursuant to Decree-Law No. 165 as a "failed experiment."[23] Feinberg writes:

> Initially, the government trumpeted the number of firms opening operations in the FTZ. By the end of 1999, for example, the government reported there were 220 FTZ operators hailing from 26 countries ... by May 2000, the number was said to have jumped to 237 operators, with more than 23 others pending approval. But it turned out that most of these firms were engaged not in manufactured exports, but rather in services and storage. In some cases, they were engaged in selling into the domestic market under special exemptions granted by Cuban authorities. ... Gradually, the FTZ experiment was abandoned and in 2004 the FTZs were relabeled "development zones," with an even more ambitious goal: the promotion of higher value-added production. In fact, the FTZ were closed or allowed to lay fallow. The permits granted to trading and service companies in the FTZs were quietly revoked, and businesses were closed or transferred outside of the FTZs.[24]

To Willmore's point, the extreme differences between salaries received by Cuban workers employed by foreign companies operating in Cuba and the amount those companies pay to the hiring entity for the workers' services are illustrated in Table 1. The information underlying the table originates from an undated study of over 24,000 workers subject to these salary arrangements (in joint ventures, subsidiaries of foreign companies, enterprises in free trade zones) conducted by a researcher on behalf of the Economic and Commercial Office of the Spanish Embassy in La Habana[25] and do not refer to ZDEM workers. Take, for example, an unskilled worker: the Cuban hiring entity paid this worker 150 pesos or \$6.25 per month, while the hiring entity received \$265 per month from the foreign operator for his or her services, so that the worker received roughly 4.2% of the dollar amount paid by the foreign operator and the hiring entity realized 95.8%. For other categories of workers, the shares of the amount paid by the operator to the worker and to the hiring entity were 2.5% and 97.5%, respectively, for low to high-skilled workers; and 2.7% and 97.3%, respectively, for executives and directors.

Table 1. Salary Paid by Foreign Operator and Received by Cuban Worker (Per month)

	Salary Paid by Foreign Operator to Hiring Entity	Salary Paid by Hiring Entity to Cuban Workers	
Employee Category	U.S. Dollars	Cuban Pesos	U.S. Dollars[a]
Unskilled	297.0	150	6.25
Low skill level	343.5	205	8.54
Medium skill level	420.1	260	10.83
High skill level	524.5	335	13.96
Executives	629.0	410	17.08
Directors	663.9	435	18.13

a. Calculated using the exchange rate \$1 = 24 Cuban pesos.

21. Spadoni, "The Current Situation of Foreign Investment in Cuba," p. 133.

22. Larry Willmore, "Export Processing Zones in Cuba," in Archibald R.M. Ritter, editor, *The Cuban Economy* (Pittsburgh: University of Pittsburgh Press, 2004), p. 64.

23. Richard Feinberg, *The Cuban Economy: What Roles for Foreign Investment?* (Washington: The Brookings Institution, December 2012), p. 16.

24. Feinberg, *The Cuban Econ*omy, p. 17.

25. Gregorio Dávila Díaz, "El mercado laboral cubano para empresas extranjeras," Embajada de España en Cuba, Oficina Económica y Social. I am grateful to José Alvarez for providing me with a copy of this report. See also José Alvarez, "Foreign Investment in Socialist Cuba: Uncertain Real Profits for Foreign Capital and Continued Exploitation of the Labor Force," Foundation for Human Rights in Cuba (May 1, 2014).

THE ZEDM: INSTITUTIONAL DEVELOPMENTS AND INCENTIVES

News and statements about the construction of a shipping port at Mariel, including a large container terminal, and of the ZEDM tend to be conflated and are difficult to disentangle. In this section of the paper, we first trace the historical development of the Mariel shipping port and then focus on the ZEDM and its system of investment incentives.

The Mariel Shipping Port

In October 2007, the international press reported that after two years of negotiations, the Cuban government was close to approving a proposal from Dubai Ports World (DP World), the world's third-largest container port company, for an investment of $250 million (also given as $300 million) to modernize the port of Mariel and build a container terminal there.[26] According to the reports, the Emirati company DP World had already launched a feasibility study of the project, which could start operations as early as 2012. For reasons that have not been thoroughly explained, the DP World proposal did not go forward.[27] In February 2009, the Brazilian Ministry for Industry, Development and Trade (MDIC) and the Brazilian Agency for Industrial Development (ABDI) signed an agreement with the Cuban government for a loan of $300 million to finance the modernization of the port of Mariel, with a Brazilian company to lead the construction.[28] Brazilian officials indicated that the price tag for the full project could be as much as $2 billion and would take 5 years to complete, with the first phase estimated to cost some $600 million.[29] In March 2010, during a visit to Cuba of President Lula da Silva, Cuba and Brazil signed a number of documents formalizing the project, including a joint venture agreement between Cuban entity Quality Couriers International S.A. and Brazilian multinational construction company Odebrecht S.A.[30] The Brazilian Ambassador to Cuba stated to a reporter in September 2012 that Brazil's interest in the development of the Port of Mariel was "in the first instance to sell Brazilian engineering services and equipment; it is not a donation. We are working closely with the Cuban government to cre-

26. "Dubai Ports studies building Cuba container terminal," Reuters (October 19, 2007); "Bye-Bye Embargo?," *The Economist* (November 22, 2007); Wilfredo Cancio, "Mariel se convertirá en moderna terminal," *El Nuevo Herald* (November 30, 2007). DP World's interest in the port of Mariel stemmed from its acquisition in March 2006 of British corporation Peninsular & Oriental Steam Navigation Company (P&O). Since the 1920s, P&O operated cruise and ferry services between Cuba and Florida ports until they were terminated in the 1960s. P&O reportedly had a long-term interest in modernizing the port of Mariel. In November 2000, the international press reported that a consortium of firms representing the ports of Rotterdam and Moerdijk in the Netherlands and Willstead in Curacao and the Dutch metal trader Fondel International B.V. was negotiating a joint venture with Cuban authorities to develop the port of Mariel. See "Dutch Metals Group Looks to Cuba Port Development," Reuters (November 4, 2000).

27. Although the exceptionally favorable financial deal from Brazil might have been the deciding factor, arguably relations with the United States—and more specifically concerns that might arise in the U.S. should the port of Mariel be built and managed by a Dubai company—might have also played a role. In 2006, DP World was involved in a national security controversy in the United States. By virtue of its purchase of P&O, DP World had acquired management of facilities at six major U.S. seaports (New York, New Jersey, Philadelphia, Baltimore, New Orleans and Miami) and sixteen others. The issue at hand was whether the fact that the government of Dubai in the United Arab Emirates owned DP World threatened U.S. national security. To address the concerns, after long and complex negotiations, a deal was struck in early 2007 whereby DP World sold the management of its U.S. port facilities to a U.S. entity, American International Group (AIG). See "AIG, DP World Reach Deal with Agency on Port Sale," Bloomberg News (16 February 2007). Although DP World was one of the bidders, the Cuban government selected Singaporean company PSA International to manage the Port of Mariel. See Marc Frank, "Cuba bids to lure foreign investment with new port and trade zone," Reuters (25 September 2013).

28. "Brazil: BNDES finances Cuban Port of Mariel," Global Trade Alert (February 4, 2014), http://www.globaltradealert.org/measure/brazil-bndes-finances-cuban-port-mariel

29. Jeff Franks, "Brazil to help finance Cuban port project," Reuters (July 9, 2009).

30. Larry Luxner, "Brazil's Odebrecht revives Mariel port," *CubaNews* (March 1, 2010). Quality Couriers International S.A. seems to be a subsidiary of Almacenes Universales, which in turn is associated with Grupo GAESA, a conglomerate of enterprises owned and operated by the Cuban Armed Forces. See Polina Martínez Shvietsova, "The Two Mariels: Mega-Port and Ghetto," *Cubanet*, May 21, 2014.

ate a transportation infrastructure that will be important to the country."[31]

The main contractor for the port was Obedrecht Infrastructure-Latin America, a unit within the Odebrecht Group. Construction, which started in the fourth quarter of 2010, included the installation of a new international container terminal at the port of Mariel with the capacity to move 1 million containers (TEU) per year, dredging of the entrance channel and turning basin, construction of 700 meters of docks for the container terminal, a freight center, yards, water supply and waste treatment networks, all of the infrastructure required to supply electricity, and improvements to the logistics structure for the port, including construction of 11 kilometers of roads and connecting railroad lines.[32]

The price tag for the first stage of the port modernization project was $957 million, of which $682 million were financed by Brazil's Development Bank (BNDES); a condition for the approval of the BNDES credit was that at least $802 million of the total cost of the project be spent in goods and services offered by Brazilian companies. It has been estimated that some 400 Brazilian companies would benefit from the project and that 153,000 to 156,000 jobs in Brazil would be generated.[33] BNDES came under some criticism at home from the financing of the Mariel Port project; BNDES President Coutinho denied irregularities in the transactions underlying the port's construction, clarifying that the loans were given to Brazilian company Oderbrecht and not to the Cuban government. He stated: "BNDES can only grant funding to Brazilian companies responsible for providing services abroad. Our relationship is built with national companies, so that jobs can be created in Brazil."[34]

Cuban President Raúl Castro and Brazilian President Dilma Rousseuff inaugurated the first phase of the new port of Mariel, consisting of a 700-meter pier capable of receiving two container ships simultaneously, in late February 2014.[35] President Rousseuff stated that Brazil's financing for the second phase of the project would be in excess of $200 million.[36] According to a port official, the container terminal handled 57 ships and about 15,000 containers in its first six months of operation (January-June 2014); he also reported that the capacity of the terminal is 822,000 containers per year.[37]

The Mariel Special Development Zone (ZDEM)

One of the economic and social development guidelines approved by the VI Congress of the Cuban Communist Party in April 2011 called for the creation of ZDEs "to increase exports, import substitution, high technology projects and local development and to contribute new forms of employment."[38] As mentioned earlier, the legislation establishing the ZDEM—Law-Decree No. 313—was enacted in September 2013. Investment incentives for companies that locate in the ZDEM are provided in Law-Decree No. 313 and implementing regulations is-

31. Fernando Ravsberg, "Brasil y Cuba multiplican sus relaciones económicas," *Carta desde Cuba* (September 17, 2012).

32. "Odebrecht Infrastructure-Latin America Finalizes Revitalization of Mariel Port," Odebrecht press release (January 27, 2014).

33. "Brazil: BNDES finances Cuban Port of Mariel"; "ZED Mariel generó 156,000 empleos en Brasil," Opciones (January 27, 2014).

34. Luciano Nascimento, "Brazil development bank denies irregularities in funding Cuban port," Agencia Brasil (May 28, 2014), http://agenciabrasil.ebc.com.br/en/economia/noticia/2014–05/brazil-development-bank-denies-irregularities-funding-cuba-port

35. "Cuba: Inauguran primera fase del Puerto de Mariel," *Granma* (January 27, 2014); Mimi Whitefield, "First phase of Cuba's Mariel port update opens," *Miami Herald* (January 27, 2014).

36. "Dilma: Puerto de Mariel, símbolo de nuestra amistad duradera," *Granma* (January 27, 2014).

37. "New Cuban container terminal handles 57 ships in six months," EFE (9 July 2014).

38. VI Congreso del Partido Comunista de Cuba, *Lineamientos de la Política Económica y Social del Partido y la Revolución* (April 2011), http://www.cubadebate.cu/wp-content/uploads/2011/05/folleto-lineamientos-vi-cong.pdf. The guideline in question is no. 103. The content of this guideline did not change during the debate of the draft guidelines that occurred in late 2010 and early 2011 initially among the population and then among Cuban Communist Party members. See VI Congreso del Partido Comunista de Cuba, *Información sobre el resultado del debate sobre los Lineamientos de la Política Económica y Social del Partido y la Revolución* (May 2011), http://www.cubadebate.cu/wp-content/uploads/2011/05/tabloide_debate_lineamientos.pdf.

sued at about the same time by different entities of the Cuban government such as the Council of State, the Cuban Central Bank, the General Customs, and the Ministries of Science, Technology and the Environment, Finance and Prices, Interior, and Labor and Social Security. Earlier, in February 2013, the Ministry of Finance and Prices had issued special customs rules for enterprises that located in ZEDs.[39]

The incentives offered by Cuba to investors or operators (*operadores*) who locate in the ZEDM include:[40]

- streamlined customs procedures to expedite import and export transactions;
- duty-free treatment of imports of raw materials for further processing and reexport, as well as of machinery used to add value to imported raw materials and parts;
- duty drawback (duty rebate) on imported products on which duties are paid that are subsequently exported;
- 50-year contracts for investments, compared with the current 25 years, with the possibility of extension;
- 10-year exemption (holiday) on taxes on profits, with the possibility of extension based on national interest determination; profit tax capped at 12% for the life of the investment;
- exemption from employment (labor force) tax; however, subject to social security contribution capped at 14% of wages;
- exemption from sales or service tax for local transactions for the first year; subsequently capped at 1%;
- exemption from territorial contribution taxes, although subject to 0.5% tax on income for a zone maintenance and development (infrastructure) fund.
- expedited procedures for environmental impact assessments (EIA) by the Office of Environmental Regulation and Nuclear Security (Oficina de Regulación Ambiental y Seguridad Nuclear, ORASEN) and possibility for appealing adverse decisions;
- a special labor regime for workers employed in the ZEDM (discussed in detail below).

THE ZEDM'S SPECIAL LABOR REGIME

The statute establishing the ZEDM sets out that while operators who locate in the ZEDM may directly employ foreign non-resident persons to perform management or technical jobs (Article 32), employment of Cuban or foreign resident workers must be done through a Cuban government entity designated to carry out this function (Article 31).[41] National labor and social security legislation is applicable to all enterprises operating in the ZEDM (Article 33).

39. Resolución No. 85/2013, www.mfp.cu/docs/aranceles/comerciales/ac_r_85_213.pdf.

40. The incentives below are specific to investments in the ZEDM and are over and above those applicable to all other investments pursuant to the foreign investment law. The latter include issues related to property rights, repatriation of profits, percentage of foreign ownership, and so on. They are drawn from Resolución No. 85/2013 supplemented by information from "Aprueban un reglamento para las empresas que operarán en el puerto del Mariel," *Diario de Cuba* (2 April 2013); Marc Frank, "Cuba bids to lure foreign investment with new port and trade zone," Reuters (23 September 2013); and Arch Ritter, "The Tax Regimen for the Mariel Export Processing Zone: More Tax Discrimination of Micro-enterprises and Citizens?" (26 September 2013), The Cuban Economy/La Economia Cubana, http://thecubaneconomy.com/articles/2013/09/3802/

41. According to the website of the ZEDM, www.zedmariel.com, as of July 2014, there were 12 "designated" employment entities, namely, Agencia Almacenes Universales S.A. del Grupo de Administración Empresarial; Grupo Grupo de las Industrias Biotecnológica y Farmacéutica BIOCUBAFARMA; Empresa Empleadora del Ministerio de la Construcción; Empresa Comercializadora de Servicios Técnicos y Tecnológicos TECNOSIME del Ministerio de Industrias; Empresa de Servicios de Ingeniería Eléctrica Cubana S.A. (SIECSA); Empresa de Preparación y Suministro de Fuerza de Trabajo de CUBAPETROLEO (PETROEMPLEO); Empresa Empleadora del Ministerio de la Agricultura (CUBATABACO); Empresa de Servicios Especializados del Ministerio de Comunicaciones (DELTA); Empresa Empleadora del Minsterio de Turismo (TUREMPLEO); Empresa Empleadora del Ministerio de Transporte (AGEMPORT); Corporación CUBARON S.A. de la Industria Alimentaria; and Inversiones GAMMA S.A. del Ministerio de Ciencia, Tecnología y Medio Ambiente. This is a departure from prior practice, whereby a single entity, ACOREC S.A. (Agencia de Contratación a Representaciones Comerciales), and to a lesser extent Cubalse S.A. (Cuba al Servicio del Extranjero), fulfilled this role. Cubalse was dissolved in May 2009 and its functions distributed to other government entities, with employment agency functions transferred to Palacio de Convenciones (PALCO). See Andrea Rodríguez, "Disuelven la corporación estatal Cubalse," AP (June 3, 2009) and "El gobierno desmantela la corporación Cubalse," *Cuba Encuentro* (June 3, 2009).

Chapter V of the ZEDM regulations issued by the Council of Ministers addresses the labor regime.[42]

- The operator (investor) and the designated Cuban entity are required to enter into a labor supply agreement that specifies, among other things, the number and skill set of workers to employed, the pay workers will earn, length of time of employment, provisions for the termination or "return" (*devolución*) of the worker to the hiring entity and substitution by another, and provisions for the revision of the agreement (Article 37).
- The pay that the Cuban entity will receive for the services of workers is agreed between the designated Cuban entity and the operator (Article 39);
- The regulations establish that the designated Cuban entity pays employees in Cuban pesos (Article 42).
- Special rules apply for the separation of workers, either by decision of the operator or by the worker's choice. The operator may "return" (*devolver*) a Cuban worker to the designated Cuban entity if the operator deems that the worker's performance does not meet job "exigencies," that is, the worker does not perform adequately (Article 40), provided the designated Cuban entity is compensated pursuant to a schedule set out in the regulations (Article 41).

Resolution No. 49/2013 of the Ministry of Labor and Social Security sets out the methodology whereby (1) the designated Cuban entity and the operator determine the salary level the operator will pay the entity for the Cuban workers; and (2) the designated Cuban entity sets the salary level for the Cuban workers.[43] It is evident from Box 2 that the two labor compensation determinations, by design, are independent of each other. That is, the pay that a Cuban worker would receive is not related to what the foreign operator pays for his/her services and workers are insulated from favorable developments regarding compensation in the negotiation between the hiring entity and the operator. An additional issue that bears consideration is that while the negotiations between the designated Cuban entity and foreign operators result in payments in U.S. dollars or in convertible Cuban pesos (CUC), a domestic currency that can be exchanged for U.S. dollars, Cuban workers are paid in Cuban pesos (CUP), a domestic currency that is not freely exchangeable for U.S. dollars.

In the first half of May 2014, the Cuban government defined certain of the key parameters that will affect the compensation of ZEDM workers:[44]

- First, the Ministry of Finance and Prices set the personal tax rate for workers in the ZEDM at 5%;[45]
- Second, Ana Teresa Igarza, Director General of the Regulatory Office of the ZEDM, stated that workers would receive 80% of the payment negotiated between the operator and the Cuban hiring entity;[46]
- Third, the Ministry of Labor and Social Security set the coefficient for adjusting the salary of Cuban workers at "10," meaning that the rate of exchange between the Cuban peso (CUP) and the Convertible Cuban Peso (CUC) to determine the amount delivered to workers would be 10:1.[47]

The Cuban press has given the following example of the mechanics for determining ZEDM workers' wages.[48] Assume that the investor and the Cuban hiring

42. Consejo de Ministros, Decreto No. 316, *Gaceta Oficial* (September 23, 2013).

43. The Resolution implements Articles 39 and 44 of the ZEDM regulations issued by the Council of Ministers described above.

44. "Queda definido impuesto para personal de Zona Especial Mariel," *Cuba Debate* (May 8, 2014).

45. Ministerio de Finanzas y Precios, Resolución No. 139/2014, *Gaceta Oficial* (May 7, 2014).

46. "Régimen de contratación en Zona Especial de Mariel beneficia a trabajadores," *Cuba Debate* (14 April 2014).

47. "Régimen de contratación en Zona Especial de Mariel"; "Cuba anuncia reglas salariales para empleados de la Zona Franca del Mariel," *El Nuevo Herald* (10 May 2014); and Ministerio de Trabajo y Seguridad Social, Resolución No. 14/2014, *Gaceta Oficial* (7 May 2014).

48. René Tamayo, "Definen impuesto sobre ingresos personales para trabajadores contratados," *Juventud Rebelde* (7 May 2014).

Box 2. Salary Paid by Operators/Salary Paid to Workers

Salary Paid by Foreign Operators to Entity

The amount to be paid by the foreign operator to the Cuban entity for the supply of workers is determined through negotiations between the Cuban entity and the foreign operator, taking into account the following factors:

1. Salaries paid for positions of similar complexity in entities in the same branch or sector as the foreign operator intends to operate;
2. Salaries paid to Cuban workers, including paid annual holidays;
3. Expenses incurred by the hiring entity in the recruitment, selection and training of workers.

The Resolution clarifies that the reference salaries paid to Cuban workers (b above) are those corresponding to the types of positions demanded by the foreign operator and are based on: (1) the base salary (per the official salary scale); (2) benefits in the current labor legislation, such as differentials for night shift or irregular shifts, payments for lodging, profit sharing; and (3) premiums for experience (seniority) and advanced education, if such special skills are required by the operator.

Salaries may be adjusted as a result of annual assessments by the parties of business outcomes and conditions.

Salary Paid by Entity or Domestic Operators to Cuban Workers

The amount that the Cuban entity pays workers takes into consideration:

1. The complexity of the work, working conditions and additional requisites associated with the position;
2. Applicable pay-for-performance pay systems;
3. Coefficient[a] and payments to the hiring entity for the service of supplying the labor force.

In determining the salary to be paid to workers, domestic operators take into account the following considerations:

- Salary levels are tied to the performance of the enterprise;
- Salary adjustments from tying of salary levels to performance (piece work, piece rates) will be financed by the entities pursuant to fulfillment of performance criteria;
- Salary limits are set by the ratio of salary expenditures to planned gross value added;
- Directors of entities are responsible for the approval of pay-for-performance pay systems.

The base salary is the average salary in the province of La Habana at the close of the year preceding the negotiations to establish the enterprise.

Source: Ministry of Labor and Social Security, Resolution No. 49/2013.

a. Coefficient seems to be an arbitrary rate to convert worker salaries from pesos to dollars.

entity have agreed that a certain job would be remunerated at the rate of $1,000 or 1000 CUC per month. Applying the 80%-20% split between the worker and the hiring entity, the worker would receive $800 or 800 CUC and the hiring entity $200 or 200 CUC. With a coefficient (exchange rate) of 10, this would mean that the Cuban worker would realize 8,000 CUC per month; the personal tax on an income of 8,000 CUP (5%) would be 400 CUP, for a net salary of 7,600 CUP. That is, out of the amount paid by the investor ($1000 or 1000 CUC, equivalent to 24,000 CUP at the current CUP/CUC exchange rate) the worker would receive 7,600 CUP or about 32%.

Compared to the previous arrangements, ZEDM workers will realize a considerably higher percentage of the amount paid for their services by foreign companies, but the degree of state confiscation of worker salary is still very high at about 68%.[49] First, the permanent 20% levy on salaries for services lent by the state hiring entity is unprecedented and excessive.

State employment agencies around the world usually offer their services to local workers free of charge: their objective is to provide labor market information and intermediation services to better match labor demand and supply and their work is perceived as a public good.[50] When there is a charge to either workers or employers, it tends to be nominal and assessed only once or as needed, while the 20% rate accruing to the Cuban state hiring entity seems to be unrelated to the level of services performed and permanent.

Second, the so-called adjustment coefficient that is applied to workers' salaries is arbitrary and, at least at the level initially set, disadvantageous to workers. As discussed above, the adjustment coefficient—essentially the exchange rate—for 2014 has been set at 10, while the official exchange rate at government-run exchange houses is $1 or 1 CUC equivalent to 24 CUP. This means that Cuban workers realize only about 42% of the number of CUP that they would obtain using the official exchange rate.[51]

Combining the two adjustments and the individual tax rate, and again using the hypothetical Cuban worker for whom a foreign company pays $1,000 or 1000 CUC per month, this worker would realize $317 or 317 CUC, less than one-third of the amount the investor pays for his or her services, while the state retains over two-thirds. In CUP, the distribution of the 24,000 that the foreign investor pays for a worker is 7,600 CUP for the worker and 16,000 CUP for the state.

ZEDM INVESTMENT INCENTIVES IN A COMPARATIVE FRAMEWORK

Cuba has high expectations about attracting significant amounts of foreign investment into the ZEDM and into the economy at large in the coming years. In an interview on Cuban television about the newly-enactment foreign investment law in late March 2014, Minister for Foreign Trade and Investment Rodrigo Malmierca stated that Cuba needs to attract between $2 billion and $2.5 billion annually in order for the economy to grow at the 7% per annum rate planners have set as a target for the next few years. "If the economy does not grow at levels around 7%," said Malmierca, "we are not going to be able to develop. … We have to provide incentives in order for them [foreign investors] to come."[52] How do incentives offered by the ZEDM compare with those offered by other locations competing for incoming foreign investment? Will the incentives be the bait for attracting foreign investment to the island?

As discussed earlier, attracting foreign investment through incentives based on export-oriented schemes is not new and is practiced by many countries around the globe. A recent study of systems and incentives for export and investment promotion in Central America and the Dominican Republic conducted by ECLAC[53] reports that since the mid-1980s, the subject countries shifted their economic strategy from import substitution to export promotion and better integration of their economies into the global economy. Although each of these countries followed a somewhat different path, influenced by internal and external factors, they all wound up developing "a complex system of incentives for local and foreign companies that export to international markets."[54] The suite of incentives these countries developed has significant commonalities: exemption from income duties, income tax holidays, and exemption from taxes on certain services. In some settings, incentives also included soft loans or loan guarantees, below-

49. Pérez posits that this is probably the highest personal income tax rate in the world. See Lorenzo L. Pérez, "Cuba: Assessment of the New Tax Law of 2012," *Cuba in Transition—Volume 24* (Washington: Association for the Study of the Cuban Economy, 2014).

50. This point is well made by Marlene Azor Hernández, "Los nuevos parásitos estatales," *Cuba Encuentro* (23 April 2014).

51. Dimas Castellanos, "Los salarios de Mariel: una buena y muchas malas," *Diario de Cuba* (24 April 2014).

52. Daniel Trotta, "Cuba approves law aimed at attracting foreign investment," Reuters (29 March 2014).

53. Economic Commission for Latin America and the Caribbean, *Foreign Direct Investment in Latin America and the Caribbean 2010* (Santiago de Chile: ECLAC 2011), Chapter titled "Current and new generation incentives for attracting investments and promoting exports."

54. *Foreign Direct Investment in Latin America and the Caribbean 2010*, p. 84.

market rate rentals for factories, other infrastructure subsidies, and derogation from regulations. The investment incentives offered by EPZs and other forms of export-oriented areas worldwide include:

- exemption from some or all export taxes;
- exemption from some or all duties on imports of raw materials or intermediate goods;
- exemptions from direct taxes such as profit taxes, municipal and property taxes;
- exemption from indirect taxes, such as value-added taxes on domestic purchases;
- exemption from national foreign exchange controls;
- free profit repatriation for foreign companies;
- provision of streamlined administrative services especially to facilitate import and export;
- free provision of enhanced physical infrastructure for production, transport and logistics;
- "social" incentives such as exempting or limiting the application of labor legislation in zones or when unions are banned from the zones.[55]

A cursory comparison of the financial incentives offered by the ZEDM and by zones in other countries with which the ZEDM would compete for incoming investment does not reveal any individual incentive or combination of incentives that would give the ZEDM a decisive edge.[56] In fact, the ZEDM's financial incentives may well fall short of those of potential competitors with respect to subsidized infrastructure for production facilities (factory shells or warehouses), relocation grants, R&D support, free land or land subsidies, soft loans and loan guarantees, among others.

It is debatable whether the ZEDM's special labor regime actually is actually an incentive to investors. Generally speaking, investment incentives in the labor/social area take the form of lower minimum wage rates or derogation from the application of protective labor/social legislation within the special zones. Arguably, the ZEDM's prohibition on investors directly hiring, directing and compensating their workers is not desirable for those investors who wish to actively manage their labor forces. Moreover, the ban on direct employment is problematic with respect to several international conventions of the ILO[57] and could discourage responsible investors from locating in a setting where international labor standards are systematically violated.[58]

Also problematic for some responsible investors would be the ZEDM pay arrangements that allow the government to confiscate a large percentage (68%, as discussed above) of a worker's earnings. But in addition to the concern about confiscation, it is not clear that the arrangements would necessarily mean lower wage costs for investors, as the rate investors pay the Cuban entity for Cuban workers is negotiated between the Cuban state and the investor, with the state holding monopoly power over the human resource input. As we understand it, the negotiated rates are not grounded on national wage rates.

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55. Jamie K. McCallum, *Export processing zones: Comparative data from China, Honduras, Nicaragua and South Africa*, Industrial and Employment Department, Working Paper no. 21 (Geneva: International Labour Office, March 2011), pp. 1–2.

56. For example, under its Free Trade Zone Regime, the Dominican Republic offers exemptions from all taxes, duties, charges and fees for production and export activities in the zones for a period of 25 years for entities located near the Dominican-Haitian border and 15 years for those located in the remaining parts of the country; Guatemala offers an exemption from income tax for 12 years; and El Salvador does the same for 15 years. See *Latin American Tax Handbook* (Amsterdam: IBDF, 2010).

57. For example, Convention 122, Employment Policy Convention, adopted by the ILO in 1964 and ratified by Cuba in 1971. In 1991, the International Confederation of Free Trade Unions (now the International Trade Union Confederation) complained to the ILO Committee of Experts that Cuba's foreign investment law, which required that all workers in foreign enterprises in the island be employed through a government hiring agency, violated the principle of "free choice of employment" in Convention 122. See ILO Committee of Experts on the Application of Conventions and Recommendations (CEACR), Observation adopted 1992, 79th ILC Session (1992), http://www.ilo.org/dyn/normlex/en/f?p=1000:13100:0::NO:13100:P13100_COMMENT_ID:2105538

58. For a very throrough treatment of Cuban labor legislation and its intersection with foreign investment see, Jesús R. Mercader Uguina, *La Realidad Laboral en Cuba y la Responsabilidad Social de los Inversores Extranjeros* (undated), at http://www.cubasindical.org/grscc/

CONCLUDING REMARKS

The Cuban government has high expectations that the ZEDM and the new foreign investment law will have a positive impact on incoming foreign investment. President Raúl Castro has referred to the ZDEM as "the most important endeavor (*obra*) being carried out in the nation."[59] Cuba hopes that foreign investment in pharmaceuticals, value added services and high technology production and exports will locate in the ZEDM, boosting exports and creating good quality jobs for Cuban workers. It is not entirely clear, however, why Cuba expects the ZEDM to succeed when earlier efforts to create free trade zones and industrial parks ended in failure and there have not been radical changes in the economic and institutional environment that would justify a different outcome.

The response to date from international investors to the ZEDM has been cautious. The ZEDM's official website (www.zedmariel.com) is silent on the number or types of investment projects that have been consummated or are under discussion. The only information available—as is often the case with Cuban economic data—originates from press reports citing government officials.

- An article published in February 2014 in a Mercosur publication attributes to the Director General of the Regulatory Office of the ZEDM the statement that at the end of January 2014, 72 investment proposals had been submitted, of which 35 were under active consideration, 17 were at an earlier stage ("under analysis"), and 20 had been rejected; reportedly 54% of the projects involved European investors, 29% Latin American investors, and 17% Asian investors.[60]
- The same source also reported that investors' interest focused on light industry, production of containers and packaging materials, chemicals, steelmaking, construction materials, pharmaceuticals, and logistics, with memoranda of understanding already signed between Cuban and with Brazilian investors with respect to the production of containers and packaging materials, cigarettes, biotechnology and pharmaceuticals.[61]
- In April, the Cuban press carried a statement attributed to the aforementioned government official to the effect that proposals from 15 investors from Spain, Russia, Italy and Brazil seeking to establish operations in the ZEDM were under consideration, with investors working on feasibility studies in the areas of "traditional" industries, food industry and biotechnology.[62]
- In June, sources associated with the ZEDM stated that "around 23 projects from investors from countries such as Spain, France, Italy, Germany, Brazil, China, Russia are among the priorities for the feasibility of the proposed" and some of them may be "installed" in the area prior to the end of 2014. Moreover, another 20 projects were being worked on.[63]
- In late August 2014, a well-informed foreign journalist based in Cuba reported that Cuba had yet to attract new foreign investors into the ZEDM, although negotiations were still on-going regarding investments in light manufacturing, packaging, alternative energy, pharmaceuticals, and warehouse shipping logistics. Three foreign companies that have already had joint venture relationships with Cuban entities—British conglomerate Unilever, French beverages company Pernod Ricard, and Brazilian-British cigarette maker BrasCuba—are reportedly negotiating investments in the ZEDM.[64]

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59. Leticia Martínez Hernández and Yaima Puig Meneses, "ZED Mariel: Es la obra más importante que se está haciendo en el país," *Trabajadores* (March 9, 2014).
60. "Más de 70 firmas de Europa, Brasil y China interesadas en megapuerto cubano," www.mercosurabc.com (February 21, 2014).
61. Ibid.
62. "Zona de Desarrollo del Mariel se apresta a recibir unas 15 inversiones internacionales," *Cuba Debate* (April 11, 2014).
63. Yudy Castro Morales, "First projects investors could settle in Mariel before closing 2014," *Cuba Contemporanea* (June 18, 2014).
64. Marc Frank, "Cuba struggles to attract investment despite reforms," Reuters (August 21, 2014).

The extent to which the establishment of the ZEDM and the supporting actions by the Cuban government will actually translate into inflows of foreign capital is very difficult to predict, however, and will depend on the investment climate, "the set of location-specific factors shaping the opportunities and incentives for firms to invest productively, create jobs, and expand."[65]

A review by World Bank economists of a set of 30 recent empirical studies of the determinants of foreign direct investment in developing and transition economies revealed that the size and growth potential of the host market were significantly associated with investment inflows; so were institutional and regulatory quality—that is, investment climate—and trade openness.[66] Fiscal and other forms of investment incentives did not appear to be significant determinants. As a paper presented at a World Bank Group workshop on the role of incentives in attracting investment put it, "Investment climate is the cake. Incentives are the icing on the cake."[67] The elusive investment climate will be the key to the success of the ZEDM.

65. Warrick Smith and Mary Hallward-Driemeier, "Understanding the Investment Climate," *Finance and Development* (March 2005), p. 40

66. Kusi Hornberger, Joseph Battat and Peter Kusek, "Attracting FDI: How Much Does Investment Climate Matter?," *Viewpoint*, no. 327, Financial and Private Sector Vice Presidency, The World Bank (August 2011).

67. "Attracting Investments Without Tax Incentives," paper presented at the workshop "The Role of Incentives in Attracting Investments," Joint Vienna Institute, Vienna, January 26–27, 2010. https://www.wbginvestmentclimate.org/advisory-services/investment-generation/investment-policy-and-promotion/upload/Attracting-Investments-Without-Tax-Incentives.pdf