The New Cuban Economy
What Roles for Foreign Investment?

Richard E. Feinberg

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# Table of Contents

Acknowledgements ................................................................. iii

Abbreviations. ................................................................. iv

Introduction ................................................................. 1

1. The Cuban Economy Today: How FDI Fits In ................................. 7

2. Few Foreign Firms, Big Contributions ........................................ 19

3. Case Studies of Joint Ventures in Cuba ...................................... 28

4. The Diaspora as Investors ................................................... 63

5. Costa Rica’s Warm Climate for FDI: Lessons for Cuba .................... 66

6. Policy Recommendations .................................................. 73

About the Author .............................................................. 77
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The New Cuban Economy: What Roles for Foreign Investment?
Latin America Initiative at Brookings
Introduction

The Cuban revolution defined itself in large measure in terms of what it was not: not a dependency of the United States; not a dominion governed by global corporations; not a liberal, market-driven economy. As the guerrilla army made its triumphal entry into Havana and the infant revolution shifted leftward, a hallmark of its anti-imperialist ethos became the loudly proclaimed nationalizations of the U.S.-based firms that had controlled many key sectors of the Cuban economy, including hotels and gambling casinos, public utilities, oil refineries, and the rich sugar mills. In the strategic conflict with the United States, the “historic enemy,” the revolution consolidated its power through the excision of the U.S. economic presence.

For revolutionary Cuba, foreign investment has been about more than dollars and cents. It’s about cultural identity and national sovereignty. It’s also about a model of socialist planning, a hybrid of Marxist-Leninism and Fidelismo, which has jealously guarded its domination over all aspects of the economy. During its five decades of rule, the regime’s political and social goals always dominated economic policy; security of the revolution trumped productivity.

Fidel Castro’s brand of anti-capitalism included a strong dose of anti-globalization. For many years, *El Comandante en Jefe* hosted a large international conference on globalization where he would lecture thousands of delegates with his denunciations of the many evils of multinational firms that spread brutal exploitation and dehumanizing inequality around the world.

Not surprisingly, Cuba has received remarkably small inflows of foreign investment, even taking into account the size of its economy. In the 21st century, the globe is awash in transborder investments by corporations, large and small. Many developing countries, other than those damaged by severe civil conflicts, receive shares that significantly bolster their growth prospects. The
expansion of foreign direct investment (FDI) into developing countries is one of the great stories of recent decades, rising from $14 billion in 1985 to $617 billion in 2010.\(^1\) While FDI\(^2\) cannot substitute for domestic savings and investment, it can add significantly to domestic efforts and significantly speed growth.

Today’s ailing Cuban economy, whose 11.2 million people yield the modest GNP reported officially at $64 billion\(^3\) (and possibly much less at realistic exchange rates), badly need additional external co-operation—withstanding heavily-subsidized oil imports from Venezuela. As with any economy, domestic choices made at home and by Cubans will largely determine the country’s fate. Yet, as Cubans have been well aware since the arrival of Christopher Columbus, the encroaching international economy matters greatly; it can be a source of not only harsh punishments but also great benefits.

In the Brookings Institution monograph *Reaching Out: Cuba’s New Economy and the International Response*, I explored the modest contributions already being made by certain bilateral and regional cooperation agencies and the larger potential benefits awaiting Cuba if it joins the core global and regional financial institutions—namely the International Monetary Fund, the World Bank, the Inter-American Development Bank, and the Andean Development Corporation. This sequel explores the contributions that private foreign investments have been making, and could make on a much greater scale, to propel Cuba onto a more prosperous and sustainable growth path.

**The Benefits of FDI**

There is a large literature examining both the various impacts of FDI on development and the best mix of national policies to maximize FDI’s favorable impacts on the economy.\(^4\) A full literature review is outside the scope of this monograph. Many academic studies run aground because of

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\(^3\) Oficina Nacional de Estadística (ONE), República de Cuba, (National Accounts, Table 5.2, “Global Supply and Demand”), [http://www.one.cu/aec2010/esp/05tabla_cuadro.htm](http://www.one.cu/aec2010/esp/05 tabla_cuadro.htm). Figure is for 2010.

certain methodological problems (e.g., is strong FDI the result or the cause of successful development?) and inadequate data (e.g., insufficiency in cross-country or time series). Much of the literature is faulted for making generalizations based upon just one or a few country studies, or for failing to disaggregate among different economic sectors. Leading authority Theodore Moran notes there are at least four separate forms of FDI—in extractive industries, infrastructure, manufacturing, and services—each generating diverse impacts and policy challenges. Still, too much research fails to make these critical distinctions.5

It would be foolhardy to imagine that all FDI provides net benefits to an economy, any more than all domestic investments. Openness to FDI exposes an economy to the vicissitudes of global market trends and to decisions made in distant corporate boards. Large-scale FDI can impact wage levels and, hence, income distribution, in some cases creating “labor aristocracies,”6 among other potentially contentious outcomes. Based upon the standard academic (“neoclassical”) economic growth model and on much empirical work—and, I would add, common sense—we can conclude that FDI can offer several very useful inputs to the host economy:

• **Investment capital:** As a result of the global boom in FDI, investment inflows now frequently contribute as much as 5 percent of a nation’s GDP, augmenting a typical level of national savings in developing countries of 20 percent by some 25 percent. This capture of external savings mitigates the trade-off between savings and consumption by allowing an increase in total savings and investment without having to squeeze popular consumption. But it is important that the capital inflows do not “crowd out” domestic savings, in the sense of relaxing societal efforts to raise national savings rates in favor of an unsustainable consumption orgy.

• **Technology transfer:** FDI is a composite bundle of capital stock, know-how, technology, and management practices. This knowledge can diffuse throughout the local economy through various transmission mechanisms: the foreign investor can pass on “best practices” to its domestic suppliers regarding quality standards, low-defect reliability, and on-time delivery; local firms can learn via imitation and competition to supply FDI firms; and talented FDI employees can depart to form or join domestic firms, transporting their new knowledge with them. But these spillovers are not necessarily automatic. Smart, carefully targeted government policies, such as vendor development programs, can actively promote them.

• **Employment and skills upgrading:** FDI typically pays higher wages than the domestic norm, reflecting greater capital intensity and labor productivity and, perhaps, greater interest in good labor relations and lower employee turnover. If FDI is of sufficient mag-

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5 Moran (2011), op.cit., p.1. One could add agriculture, and also call for further disaggregation within these sectors, e.g., exploring for petroleum and gas is very different from mining gold and silver, and within the manufacturing sector textiles and apparel is radically different from microprocessors and telecommunications.

nitude it may markedly increase the demand for labor and even place upward pressure on national wages. To fully benefit, governments and educational institutions can partner with FDI firms to provide well-matched manpower training.

- **Exports:** Especially in smaller nations, FDI firms often target international markets, and may integrate local production into global supply chains. The presence of FDI can also inspire local firms to think “international,” to make that extra effort to search abroad for new customers. But it may take an active government policy to encourage FDI to grow net exports by seeking out and educating local suppliers to substitute for imported intermediate inputs.

- **Consumer welfare:** Consumers can benefit if locally produced goods are cheaper than imported equivalents. By increasing competition or by employing new organizational practices, FDI in the retail sector can lower prices and expand consumer offerings. FDI may also improve public health and reduce consumer risk by, for example, raising quality standards in food products.

Thus, FDI offers great opportunities to capital-importing countries, but reaping the full benefits depends upon the country and policy contexts. Active national policies that maximize benefits can include quality education of technical workers, engineers, and managers; targeted incentives that encourage positive spillovers and technological learning; and carefully crafted programs that locate investments in poorer regions or that encourage hiring workers, including idle youth, women, and the handicapped, from less advantaged, high-risk backgrounds. More controversial are “performance requirements,”—e.g., mandating that FDI purchase a certain quantity of inputs from domestic vendors or meet export targets. Interestingly, Cuba, with its relatively strong governmental institutions, educated population, and commitment to the welfare of workers and social equity, is well-placed to extract big benefits from FDI.

**Cuba’s Shifting Attitudes**

The rise and fall in the stock of joint ventures (JVs) on the island has reflected the dramatic shifts in Cuban economic policies since the revolution. Over the last five decades, we can distinguish five periods (Figure 1). During the revolutionary 1960s, the regime systematically nationalized most foreign and Cuban-owned properties, beginning with large U.S.-owned properties and eventually extending to small-scale enterprises and even mom-and-pop retail outlets. Much of the educated middle class exited the island, eventually creating the prosperous Cuban-American community based in South Florida. In Cuba, Soviet-style planning came to dominate economic policymaking. In the second phase, the sudden loss of the large Soviet subsidy occasioned an interlude of liberalization, of warm welcomes to European, Canadian, and Latin American investors, often extended

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7 For a critical discussion of performance requirements, see Moran (2011), op.cit.
by Fidel Castro himself. But once the economy showed signs of recovery, Castro reevaluated the opening to foreign capital and ordered the closure of many JVs, especially smaller firms, amidst a more general recentralization of economic decision making. During the fourth phase, the Cubans turned toward state-backed projects involving Venezuela, China, and Brazil.

Figure 1. Five Phases of Cuban Policies Toward Foreign Direct Investment

<table>
<thead>
<tr>
<th>PHASE 1</th>
<th>PHASE 2</th>
<th>PHASE 3</th>
<th>PHASE 4</th>
<th>Phase 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>The revolutionary 1960s</td>
<td>The post-Soviet 1990s</td>
<td>The conservative 2000s</td>
<td>“New Socialism” Mid-late 2000s</td>
<td>Ambivalence 2011-</td>
</tr>
<tr>
<td>Nationalism and Expropriation</td>
<td>Liberalization and Welcome</td>
<td>Retrenchment and Cancellations</td>
<td>SOE Partners (Venezuela, China, Brazil)</td>
<td>Economic Reform; Anti-Corruption Campaign</td>
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Since assuming the presidency in 2008, Raúl Castro has sent contradictory signals regarding foreign investment. In principle, Cuba’s foreign investment laws offer favorable conditions and—as the case studies reveal—some JVs are successfully navigating the Cuban economic system. But the government has been keeping many suitors waiting for the final green light. Projects for large golf and marina resorts have been pending for years. The owners of the prime commercial office space in Havana have been unable to secure authorization for next-phase construction. An international hotel chain that offered to refurbish the shabby downtown Habana Libre hotel was refused an equity share. Brazilian negotiators have been urging Cuba to allow large investments in sugar mills and associated ethanol plants, only to be frustrated by “political symbolism”—lingering fears of compromising the sacred gains of the revolution and endangering national security.

Even more alarming, major JVs have recently been shuttered or challenged by the authorities for failing to meet demanding performance requirements (as the case studies discuss). Nevertheless, the government has been debating revisions to the foreign investment law, opening the possibility for a new, more positive phase in Cuba’s treatment of FDI.

Following a quick primer of the Cuban economy, the first section of this monograph assesses the elastic legal framework and chilly business climate that await prospective foreign investors. Section two digs into the numbers and distinguishes five phases of Cuban policy toward FDI—only one of which, during the 1990s, could be characterized as welcoming. While previous analyses of FDI in Cuba have tended to focus on the number of firms, I argue that investment flows have been concentrated in just a few major projects and, hence, propose a case study approach examining

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Embassy of Brazil in Havana, La industria de la caña de azúcar en Cuba, sector report, 2012.
more closely some of the larger FDI. Section three drills down into seven case studies in mining, brand exports (Cuban puros cigars), hospitality, and consumer products—demonstrating that FDI is making valuable contributions to the Cuban economy and suggesting that foreign firms would be willing to invest more handsomely in Cuba if its domestic or international markets were to expand. Section four briefly examines the role that the Cuban diaspora has already been playing in assisting the emergence of the small business sector. To place Cuban policies toward FDI in comparative perspective, section five takes a look at the remarkably successful experience of Costa Rica, a Caribbean basin neighbor that shares many similar characteristics with Cuba. The final section of the monograph offers a series of recommendations for Cuba, the international financial institutions (IFIs), and the United States, that would improve the investment climate. Adopting these measures would allow FDI to play a more central role in increasing the productivity and competitiveness of the Cuban economy, creating new opportunities and higher wages for the Cuban workforce and diffusing dynamism throughout the economy.

FDI in Cuba is shrouded in mystery. Data are scarce and executives rarely grant interviews. Hence, only a few scholars have sought to break through the mist. Drawing on a wide range of sources while protecting confidentiality, this study intends to provoke more attention to FDI by scholars and policymakers both inside and outside Cuba.

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9 Notably, Omar Everleny Pérez Villanueva, Paolo Spadoni, and Julio Cerviño, whose pioneering works are cited throughout this monograph.
1. The Cuban Economy Today: How FDI Fits In

A small island economy the size of the state of Tennessee, Cuba finds itself in the crossroads of world history and the global economy. In recent years, Cuba has suffered from the painful external shocks of exorbitant energy costs and rising food prices. And the island has been laid siege to by its formerly dominant and geographically proximate economic partner, the United States, which has imposed punishing comprehensive economic sanctions—including prohibitions against investments—unprecedented in their scope and longevity. The sudden withdrawal of Soviet subsidies in the early 1990s precipitated a major crisis but only a partial, hesitant course correction while Cuba’s Latin American neighbors made major strides forward through structural reforms and deepening engagement with the global economy. Only through such integration into the global economy can Cuba hope to modernize its factories and farms, realize economies of scale, and gain access to large markets, new technologies, and investment capital.

Tough and resilient, the Cuban economy survives and evolves—and today opening another reform chapter, one that seems likely to be more consequential than earlier turns of the wheel. This time around, Cuba can build on its impressive investments in human capital, its quality health care, and universal education, originally undertaken by the revolution largely for humanitarian reasons. Today’s high-quality workforce is a potent building block in the race toward higher earned incomes and more lucrative integration into global markets.

This section first briefly assesses the current shortcomings and inherent strengths of the Cuban economy. It then reviews the official 2011 guidelines that set forth a five-year reform program, honing in on those dozen guidelines that pertain directly to foreign investment. The description of the formal legal framework for foreign investment, still based on the 1995 foreign investment law, Law 77, pays special attention to the exhausting approval process and shifting standards that have been applied by government ministries. Finally, the discussion is extended from the formal legal...
setting to the broader concept of “business climate.” In the 1990s, an effort to establish free trade zones based on the formal legal framework failed miserably as investors judged that the business climate was overwhelmingly adverse.

The Cuban Economy: Weaknesses and Strengths

By several key indicators, the Cuban economy is seriously underperforming:

- **The Cuban economy has increasingly become a low-productivity service economy.** Industrial production is stalled at less than 50 percent of its pre-1989 levels. Agricultural output, despite some gains, remains insufficient to feed the population and hefty imports of food staples bite off a big share of foreign exchange earnings. By 2010, agricultural output had recovered from mid-decade droughts and hurricanes but only to regain 2000 levels.

- **Merchandise exports, reported at $4.6 billion in 2010, were less than 10 percent of national output, reflecting the low international competitiveness of much of Cuba's industry and agriculture.** The weak export performance opens a gaping merchandise trade deficit that Cuba struggles to finance, often by accumulating payments arrears that irritate its international partners and undermine its credit ratings. Cuba has managed to narrow its bulging foreign exchange shortfall thanks only to the largesse of Venezuela, which barters its oil for Cuban medical personnel on terms highly favorable to Cuba.

- **Especially debilitating, national savings and investment rates are very low at around 10 percent of GDP, half of the Latin American average, and even further below the strong Asian investment rates. This results in the ongoing de-capitalization of some sectors and relegating Cuba to a low-growth trap.** From 1996 to 2008, the ratio of gross capital formation to GDP averaged about 12.5 percent, startlingly low by international standards. In a survey of 157 countries, Cuba's investment rate was consistently below the lowest 10th percentile during the period from 1990 to 2008.10

As we shall see, the reforms of the 1990s did yield some important results as Cuba opened select sectors to foreign investment and commerce. In 2012, in partnerships with foreign hotel investors, managers, and tour operators, Cuba will host some 3 million tourists yielding well over $2 billion in gross receipts. A Canadian nickel mining and smelter company, Sherritt International, is generating the largest single source of foreign exchange earnings, surpassing sugar. Other JVs with major European multinationals are successfully distributing premium Cuban rum and tobacco in international markets. Without these foreign partnerships, it is likely that Cubans would have continued to suffer the near starvation-level caloric intakes experienced during the dark days of the “Special Period” of the early 1990s.

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These positive developments in international tourism, nickel and cobalt mining, and high value-added agriculture (hand-rolled cigars and vintage rums) are foundations for future growth. They have not yet, however, sufficed to lift Cuba onto a strong sustainable growth path. To overcome the critical problems still confronting the Cuban economy, the Cuban government publicly recognizes it will have to undertake more and deeper policy reforms.

**Reform Guidelines**

In April 2011, under the leadership of Raúl Castro, the Cuban Communist Party approved The Guidelines for the Economic and Social Policies of the Party and the Revolution. A lengthy document with 313 points, the official blueprint recognizes the economy’s major shortcomings and proposes pathways forward. The guidelines assert that national savings must be increased, exports need to be bolstered, and domestic production of food stuffs should substitute for imports. To accomplish these goals and raise efficiency and productivity, decision-making will be decentralized to state-owned enterprises (SOEs) and municipalities. The non-state sector—including small-scale private enterprise, cooperatives, and private farming—will grow to absorb workers shed from the bloated state sector.

As of mid-2012, some reforms were already underway and Cubans were eagerly anticipating additional measures.\(^\text{11}\) Reforms already in progress included liberalizing private markets for restaurants, bed-and-breakfast establishments, small retail shops, and other micro-businesses; private markets for some farm products; the distribution of idle state lands; and the limited buying and selling of automobiles and residential homes which has set off a burst of property registration. Reforms widely presumed to be in the pipeline included a new law encouraging and regulating non-farm cooperatives; leasing many smaller retail outlets, including cafeterias and barber shops, to their employees to operate as independent cooperatives; fiscal reforms placing greater emphasis on taxation as opposed to intra-state transfers; as a pilot project, allowing select SOEs to sell excess production on the open market, after honoring their state contracts; and of possibly great long-term significance (and also on a pilot basis), creating Organizaciones Superiores de Dirección Empresarial (Superior Organizations of Management), or industrial holdings companies, that would take over many of the management functions currently in the hands of the powerful ministries.

Even so, other important issues, many flagged in the 2011 guidelines, remain to be addressed, such as further downsizing of the bloated state payroll, unifying the distorted dual exchange rate system, and overhauling the irrational wage and labor incentive systems. In a larger sense, this includes the broadening of the scope for market mechanisms and the clarification of property

rights. In late 2012, government officials charged with reform implementation tapped economists to help define a long-term development model—whether as an exciting opportunity to clarify goals or as a bureaucratic delaying tactic remains to be seen.

Just 12 of the 2011 guidelines (numbers 96 through 107) directly address foreign investment—and these table no major policy reforms. The relevant guidelines neither recognize the critical role that foreign investment is already playing in the Cuban economy, nor do they propose that foreign investment become a central driver of growth. Nevertheless, in the internal debates during the drafting of the guidelines, the pro-reform factions did manage to insert some positive language recognizing the potential contributions of FDI: “access to advanced technology, the transfer of management skills, a diversification and expansion of export markets, import substitution, the generation of new employment,” and access to external finance.

The more orthodox factions within the government and Communist Party seem to have gained the upper hand in drafting the section on foreign investment. The conservatives inserted language revealing their enduring distrust of foreign capital and underscored the need to carefully screen projects, as well as to monitor closely those projects that are allowed to proceed:

- Foreign capital is categorized as a “supplement” to national savings. While under any likely scenario domestic savings will indeed exceed foreign capital inflows, economists in Havana interpreted the “supplemental” label as demoting FDI to playing a secondary, non-essential role in economic planning.
- Foreign investments should be carefully screened to be “consistent with the National Economic Plan” and “to make sure that the foreign capital satisfies a host of objectives.”
- The guidelines suggest that foreign investments be subject to both external and domestic performance requirements. Foreign-owned firms should purchase goods and services supplied by Cuban companies.
- Approved projects should be subject to continuous and rigorous monitoring, to ensure that the foreign partner is observing its commitments. Existing partnerships should face “assessment and adjustment” to ensure consistency “with the country’s requirements.”
- A time limit should be set for approved foreign investments to commence operations, “to avoid their continued utilization of resources indefinitely with a resulting increase in inefficiency.”

Amidst these cautionary notes, the guidelines do contain some positive news for potential foreign investors. The guidelines call for “more expedient” assessment and approval procedures. Investments that target the domestic market rather than the high-priority export sector should nevertheless be considered where they provide “indispensable” products or substitute for imports. Special Development Zones that attract FDI and promote exports and high tech projects should be created.
The guidelines also called for an up-to-date portfolio of investment projects that might be of interest to foreign partners. After persistent expressions of interest from the diplomatic community in Havana, the Cuban Chamber of Commerce—whose leadership is appointed by the Ministry of International Commerce and Foreign Investment (MINCEX)—issued such a portfolio in December 2011. But the surprisingly short list broke little new ground and addressed a truncated number of sectors. The portfolio advertised these options: in tourism, three hotel sites, two of which could include golf courses; in petroleum, risk-sharing exploration contracts in Cuba’s Exclusive Economic Zone in the Gulf of Mexico; in mining, a small nickel/cobalt refinery; in energy, projects in wind and solar; and in packaging, seven potential small joint ventures. Rather than signal a renewed interest in attracting foreign investment, the chamber’s portfolio seemed to confirm that many Cuban economic planners believed that FDI was, at best, a secondary supplement to more promising sources of growth.

**The Legal Framework**

As part of the post-Soviet economic opening, Cuba authorized a new foreign investment law (Law 77, 1995) that combines elements commonly included in such national FDI frameworks with characteristics specific to the Cuban system.

Law 77 stipulates that FDI may take the form of JVs with state firms or may be fully foreign owned. Investors enjoy full protection against expropriation, “except for reasons in the public interest” in which case they will be indemnified, and have the right to appeal to a mutually agreed upon international investment dispute resolution entity. Litigation over other disputes between FDI and state-owned enterprises or government entities is referred to the jurisdiction of national courts. FDI firms pay income taxes at a 30 percent rate of net taxable income, although reinvested income can be exempt if so authorized by the government. Additional taxes of 25 percent are levied on employee wages, composed of an 11 percent wage tax and 14 percent social security contribution. Profits and dividends are freely transferable abroad in convertible currency.

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12 Law 50 of 1982 had established a ceiling of 49 percent for the participation of foreign capital in joint ventures. Law 77 opened the door to joint ventures with either majority or minority foreign ownership shares, as well as to wholly foreign-owned ventures. Formally, Law 77 of 1995 allows for FDI to take one of several forms: 1) A joint venture in which one or more foreign investors participate with one or more national investors to form a Cuban commercial company which adopts the form of a nominal share corporation; 2) an international economic association contract, in which the national and foreign investors cooperate without the establishment of a legal entity distinct from each of the parties; and 3) totally foreign capital company, without the involvement of any national investor. An “international economic association” includes the first two forms, namely JVs and international economic association contracts. Further, regulation 5290 (2004) allows for production cooperation agreements and for administrative contracts for both goods and services, as well as for hotel administration contracts.

All sectors of the economy are open to FDI, excluding only health and education services and the armed forces. FDI firms can import and export directly (i.e., without passing through a state wholesale company).

The Approval Process

Law 77 requires formal approval by the Cuban government of each proposed investment. Authorized JVs must be registered with Cuba’s Chamber of Commerce. But the registry is not made available to the general public (although copies are known to circulate informally). Similarly, FDI firms must submit an annual report to the government, but the submissions remain confidential.

For interested investors, an especially irritating peculiarity of the Cuban FDI system is the prolonged multi-layered approval process. First, the foreign investor must draw up its application with its proposed SOE partner and the relevant ministry, and then present that request to the MINCEX. Second, MINCEX must then consult with all the corresponding agencies and institutions, which typically include the pertinent sectoral ministry, the powerful Ministry of Economy and Planning, the influential Ministry of Finance and Prices, the central bank, and the ministries of labor and environment. Third, if subsequent to these broad consultations MINCEX is favorably disposed, it makes a recommendation to the Executive Committee of the Council of Ministers (CECM), which is composed of several national vice presidents and pertinent ministers, and formally chaired by President Raúl Castro.14

Fourth, according to legal experts familiar with these procedures, the CECM normally accepts the recommendation of MINCEX, although it is not unknown for CECM to refer a proposal back to MINCEX for further elaboration.

Law 77 requires that applications be acted upon within 60 days, but in fact the FDI approval process may drag on for two years or longer, or may languish unanswered altogether. Moreover, MINCEX does not feel obliged to provide a written ruling to applicants and may or may not offer an oral explanation for its ruling.

This demanding screening process could be admired for its inclusiveness but it also contains a plethora of veto points and opportunities for delay. Applicants complain that the process is a non-transparent black box, denying access to many of the decision makers or even knowledge as to which personalities are at the table.

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14 Among the more influential personalities reportedly are Vice President Ricardo Cabrisas, MINCEX Minister Rodrigo Malmierca, and Minister of Economy and Planning Adel Yzquierdo.
Law 77 allows for 100 percent foreign ownership. Yet only six such wholly foreign-owned firms exist today: three in petroleum and energy, two in maritime transport, and one in the financial sector. Underscoring the wide degree of bureaucratic discretion in the foreign investment regime, government functionaries have chosen to largely ignore an important option that dominates FDI in most countries which would allow foreign investments independent of Cuban SOEs.

Another curious feature of the Cuban system is that FDI ventures are approved for a fixed time period—as low as 15 years—upon which time the contract is terminated, unless it is renewed by joint agreement of the parties and the government. As many FDI firms have discovered, renewal is anything but automatic and the government may seek to alter the contract terms in fundamental respects. For example, whereas in the 1990s the government often granted the foreign partner majority control, now it is seeking to revert 51 percent or more of the voting shares to the SOE partner. This revealed Cuban preference for management control discourages some investors altogether. It also drives JVs to finance themselves through higher debt—rather than equity—than they might otherwise. In another escalation of conditions placed on new JVs or those up for renewal, the government is also pressing firms to export at least 20 percent of their production. As we shall see in the distressing case of the Dutch-British multinational Unilever, the shifting demands of the Cuban state can set a bar too high.

In principle, the Cuban authorities have honored the prohibition against expropriation without compensation guaranteed in Law 77 (chapter III, article 3). But many FDI firms have been closed through the nonrenewal of contracts, or, more precipitously, by the state placing the firm in a nontenable position and forcing sale of shares to the state. The government has also seized the property of shareholders accused of corruption, as we shall see in the dramatic case of the successful fruit juice manufacturing and distribution firm Rio Zaza.

**The World’s Heaviest Tax on Labor**

The most unusual characteristic of the Cuban FDI regime is the labor contract system. FDI firms are not generally allowed to directly hire labor. Rather, a state employment agency—typically a dependency of the relevant sectoral ministry (e.g., tourism, light industry)—hires, fires, settles labor disputes, establishes wage scales, and pays the wages directly to the workers. The FDI pays the

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6 In the one international arbitration award that has been made public, the arbitral tribunal found in favor of the Cuban government in 2008, albeit with a dissenting opinion from the Italian arbitrator who rejected the claims advanced by the government of Italy under the bilateral investment treaty (BIT) on behalf of a number of smaller Italian investors. Investment Treaty Arbitration, *Italian Republic v. Republic of Cuba*, ad-hoc state-state arbitration, [http://www.italaw.com/cases/documents/582](http://www.italaw.com/cases/documents/582).
wage bill to the state employment agency which in turn pays the workers. But there is a very special twist to the Cuban system: the FDI pays wages to the employment agency in hard currency and the employment agency turns around and compensates the workers in local currency, an effective devaluation or tax of 24-to-1. Thus, if the firm pays the employment agency $500 a month and the employment agency pays the workers 500 pesos, over 90 percent of the wage payment disappears in the currency conversion; the effective compensation is instantly deflated to $21 per month. This could be the world’s heaviest labor tax. It provoked one Cuban worker to remark to the author: “In Cuba, it’s a great myth that we live off the state. In fact, it’s the state that lives off of us.”

This labor system, which also authorizes only one national union (the Confederation of Cuban Workers, which is closely allied with the Communist Party), violates many principles of the International Labor Organization, of which Cuba is a charter member. It also freezes Cuba into a low-wage, low-productivity trap.¹⁷

**Official Discretion and Shifting Standards**

The legal regime governing FDI has permitted broad official discretion. In the mid 1990s, the government welcomed and approved many JVs. But beginning in 2003, without any formal legal alterations, the government began to rigorously review existing firms and closed many that failed to meet its shifting standards, favored larger over smaller businesses, and privileged foreign SOEs over private partners.

Law 77 has been under review within the government for some time. According to a well-connected expert, the likely modifications—beyond updating language—may make the law more transparent and specific, thereby removing some of the existing bureaucratic discretion. More detailed rules may be outlined for some leading economic sectors such as petroleum and agriculture. Sections of the law that are now brief, for example those dealing with the terms and conditions under which foreigners can own and develop real estate properties, and those pertaining to duty-free zones and industrial parks, may be expanded. Furthermore, the development zones may more precisely target higher value-added technologies and firms may be permitted to operate both inside and outside the special zones, in each location under a distinct incentive regime. Experts differ as to whether JVs might be allowed to directly hire workers without the intermediation of a government workforce agency, although in any case wages would continue to be heavily taxed. Also under debate is whether the foreign partner should be allowed majority shares in specified sectors.

It remains to be seen whether any amendments to the foreign investment regime signal—both to the foreign investment community, as well as to the state bureaucrats that screen investor applications—a major change in attitude toward FDI, or whether foreign investment remains under a cloud of nationalist suspicion, exposed to shifting official preferences and increasingly demanding performance demanding performance criteria—an underperforming supplement to the national development strategy.

**The Business Climate**

What drives the international investment decisions of firms? The literature devoted to explaining the over $1 trillion in annual worldwide equity investment flows differentiates among three major categories of investments: resource-seeking investments, efficiency-seeking investments, and market-seeking investments. All three categories are, or could be, relevant to Cuba:

- Cuba’s natural resources include its inviting tropical climate, world-class vacation destinations, deep-water ports, valuable minerals (nickel, cobalt, and possibly petroleum), non-traditional energy sources (sun, wind, and waves), and arable soils.

- Efficiency-seeking investments are often attracted by relatively low-cost competitive wages. Cuba could score in two categories: highly-educated professionals with relatively low wages and low-wage workers with relatively good high school education. Still, Cuba would first have to overhaul its tax and currency policies that elevate labor costs.

- The Cuban domestic market is modest in size but still interesting to some firms, including those multinationals compulsively seeking a presence in every market worldwide. For countries located in the Caribbean Basin, the relevant export market is first and foremost the United States—not yet an option for firms operating in Cuba. Once U.S. sanctions are lifted some multinationals may use Cuba as a regional hub, serving the neighboring islands as well as the southeast United States.

Increasingly, literature on FDI focuses on what might be called the demand side: public policies of the receiving countries that affect the decisions of investors. Without negating the above-cited factors driving investment supply, governments should recognize that public policies “can tip the balance in favor of one country over another if all other factors are equal.”

In *Investing Across Borders*, the World Bank presents cross-country indicators analyzing practices, laws, and regulations affecting FDI in 87 economies. While Cuba (which is not a member of the World Bank) is not included, the results of this survey are instructive; they indicate just how much of an outlier Cuba has become with regard to the treatment of foreign investment.

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89 Ibid.
The *Investing Across Borders* 2010 edition surveyed 14 Latin American and Caribbean countries.\(^{20}\) Among the relevant findings for the region:

- *None* of the 14 countries require special approval procedures for foreign, as opposed to domestic, investment. That is, foreign investment is granted “national treatment.”

- Most economic sectors are fully open to FDI. In tourism, light manufacturing, construction, and retail, the 14 countries place *no* limits on foreign equity ownership. A few countries (Bolivia, Haiti, and Mexico) impose restrictions in banking, insurance, and telecommunications. Some countries protect their electricity sector.

- Starting a foreign business from scratch typically takes under six months, except in Haiti where it takes seven months. For example, it takes only two months in Costa Rica and 29 days in Chile.

- The World Bank found that countries around the world with smaller populations and markets tend to have *fewer* restrictions on FDI. Large countries—like China and Brazil—can offer their expanding domestic markets as bait to investors. In comparison, smaller economies like Cuba must compete more aggressively and make good use of the public policy tools at their disposal.

As noted above, in Cuba all applications for FDI must pass through a complex and non-transparent review process, raising obstacles not present in many other Latin American and Caribbean countries. While Cuba’s foreign investment law allows for FDI in most sectors, investments of any significant size have been increasingly circumscribed to a few select sectors (tourism, natural resources, and international marketing). The foreign investment law promises a ruling on an investment application within two months, but aspiring investors report delays measured not in months, but in years.

One key conclusion of the 2010 *Investing Across Borders* survey particularly relevant to Cuba’s future: “Easily accessible and reliable information and efficient and predictable actions by public institutions help create a business environment conducive to investment.”

**Free Trade Zones: A Failed Experiment**

On the heels of the 1995 Foreign Investment Act, which aimed “to broaden and facilitate foreign participation in the nation’s economy,” Cuba introduced Decree-Law 165, establishing a framework

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\(^{20}\) These are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Peru, and Venezuela.
for industrial free trade zones (FTZs).\textsuperscript{21} To attract assembly manufacturing ("maquilas") that would create jobs and boost exports, the FTZ law offered the standard mix of incentives common to FTZs worldwide, including exemptions from tariffs and taxes for 12 years and unimpeded transfers of profits. While the main goal was to stimulate exports, investors were permitted to market up to 25 percent of production in the Cuban market.

To implement Decree-Law 165, Cuban authorities quickly opened four FTZs, two in the Havana region (Berroa and Wajay) and one each at the port facilities of Mariel and Cienfuegos. A holding company of the Cuban military (FAR), Almacenes Universales S.A., was granted the concession to administer three of the FTZs (Wajay, Mariel and Cienfuegos), while the fourth FTZ was awarded to CIMEX—the large state-owned enterprise in wholesale distribution and retail marketing.

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—notably from Spain, Italy, Canada, Panama, and Mexico. By May 2000, the number was said to have jumped to 237 operators, with more than 23 others awaiting approval.\textsuperscript{22} 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. The government reported that of 243 FTZ enterprises registered at the time, 160 were trading companies and 49 were in the service sector, but only 39 were in manufacturing.\textsuperscript{23}

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 FTZs 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.

Why the stark failure of the FTZ experiment? FTZs work on the basis of two key incentives: lower production costs, usually based on relatively cheap labor, and access to external markets secured either through preferential trading arrangements (such as free trade agreements), or commercial channels opened through intra-firm transfers or supply chains. But Cuba offered neither of these

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key investment drivers. Access to the major market dictated by geography—the United States—was closed by U.S. sanctions. Moreover, Cuban labor costs were dramatically inflated by the prohibitive government tax on labor. A 2000 United Nations study estimated the costs to FTZ employers of Cuban labor at an average $1.75 per hour, versus $0.94 per hour in the neighboring Dominican Republic and $0.50 to $0.75 per hour in Central America.\(^{24}\) The Cuban government had simply priced itself out of the market.

Today, neither of these two hurdles to attracting manufacturing foreign investment in Cuba—government-inflated labor costs and the closed U.S. market—has yet been overcome. In the expansion of the Mariel port facilities to be executed by the Brazilian firm Oderbrecht and operated by PSA International of Singapore, a large-scale “special development zone” is under construction (see Figure 1.1). There is much talk of attracting biotech and other high value-added ventures. Yet, the danger lurks that such investments will be deterred by inflated wage costs and closed markets; inadequacies in logistics and infrastructure; and ambiguous, shifting public policies.

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2. Few Foreign Firms, Big Contributions

Assessing foreign investment in Cuba is complicated by the scarcity of data. The Cuban government’s culture of secrecy takes on extreme form when it addresses international capital flows. Spectacularly, Cuba simply does not publish a capital account! Cuba releases no numbers on capital inflows or outflows, nor is there an official accounting of foreign reserves. And offerings within the current account that record capital-related flows are presented in highly aggregate form: there is but one line for “renta” (income) which includes transactions (both outgoing and incoming) on interest, dividends, and profits, “among others.”

When pressed for an explanation, the Cuban government points to U.S. hostility, affirming that the U.S. Treasury might take advantage of greater transparency to harass Cuba’s economic partners or seize Cuban assets. These fears may well be justified, demonstrating yet another example of how U.S. sanctions engender precisely the behavior pattern—in this case, extraordinary state secrecy—that the U.S. decries. In spaces where Cuba apparently feels less threatened, such as social indicators, or even the direction and composition of merchandise trade, statistics are made more readily available.

Estimating FDI Flows

For more normal nations, international organizations are a good source of information on foreign investment flows. But not so in the case of Cuba, since the governments that are the primary sources of information on FDI flows chose not to release most Cuba-related data, either because they do not have the information or chose not to disclose it in deference to confidentiality concerns. Those numbers that are released woefully understate flows and are discounted by knowledgeable Cuban economists. For example, the United Nations Conference on Trade and Development (UNCTAD) estimates

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for Cuba an accumulated foreign investment stock of just $215 million for the years 1990 to 2009, $97 million of which are attributed to 2007 to 2009.26 The World Bank publishes almost identical numbers, showing $210 million in FDI net inflows during 1994 to 2009 (and $85 million in 2010).27 In tension with these numbers, the International Monetary Fund’s Coordinated Direct Investment Survey indicates that Spain alone reported direct investments in Cuba of $583 million (end-2010).28 But these reported numbers clash with the magnitude of foreign investment activities that are readily visible on the island and are recorded in the annual reports of international firms engaged in Cuba.

During the brief period between 1993 and 2001, the Cuban government did publish some limited, highly aggregated data on foreign investment flows. Cumulatively, reported flows through 2001 totaled $2 billion (Table 2.1).

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Flow</th>
<th>Cumulative</th>
</tr>
</thead>
<tbody>
<tr>
<td>1993</td>
<td>54.0</td>
<td>54.0</td>
</tr>
<tr>
<td>1994*</td>
<td>563.4</td>
<td>617.4</td>
</tr>
<tr>
<td>1995</td>
<td>4.7</td>
<td>622.1</td>
</tr>
<tr>
<td>1996</td>
<td>82.1</td>
<td>704.2</td>
</tr>
<tr>
<td>1997</td>
<td>442.0</td>
<td>1146.2</td>
</tr>
<tr>
<td>1998</td>
<td>206.6</td>
<td>1352.8</td>
</tr>
<tr>
<td>1999</td>
<td>178.2</td>
<td>1531.0</td>
</tr>
<tr>
<td>2000</td>
<td>448.1</td>
<td>1979.1</td>
</tr>
<tr>
<td>2001</td>
<td>38.9</td>
<td>2018.0</td>
</tr>
</tbody>
</table>

* The reported flows jump in 1994 when the government decided to fold in flows from years prior to 1993.

This useful series was discontinued after 2001, when another emerging option caught Cuba’s attention: the availability of state-owned capital in countries, notably Venezuela and China, which offered certain advantages from the Cuban perspective. These friendly powers were prepared to offer capital on subsidized terms and in ideologically comfortable state-to-state deals.29 For these state-to-state

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deals, notoriously non-transparent and often not reported to the international agencies that track FDI, it is extremely difficult to estimate actual investment flows; to disentangle announcements, commitments, and on-the-ground implementation; and to decipher whether the deal is structured in the form of equity (wholly-owned or JVs), an arms-length service contract, or as a production sharing agreement (as is often the case in the petroleum sector). The capital flows may not qualify as FDI at all, but rather as state banking loans. This has been the case with the Brazilian involvement in the Mariel port expansion and in the renovation of a sugar refinery in Cienfuegos province—projects often erroneously labeled in the media as “investments.”

Perhaps the best informed estimate of the stock of Cuba FDI comes from an international financial consultant (who wished to remain anonymous) with privileged access to foreign investment data. The source noted that according to the Cuban central bank, FDI inflows as of 2001 totaled $1.9 billion (very close to the published figure of $2.02 billion, Table 2.1) and estimated that by 2009 the total stock may have reached $3.5 billion. He added another telling estimate: 20 investors accounted for nearly $3 billion of the $3.5 billion; indeed, the top 10 investors accounted for the lion’s share. The remaining universe of some 200 JVs (Graph 2.1), therefore, would account for only about $500 million in investment capital, or an average of $2.5 million per project.

**Joint Ventures: Numbers and Size of Firms**

Cuban economists working on FDI have made use of data not on dollar-volume of FDI flows, but rather on the number of joint venture projects broken down by economic sector and country of origin. These project numbers are generally sourced to unpublished government documents and occasionally to press reports in the official Cuban media. The aggregate numbers do not indicate the capital value or strategic importance of the projects and lump together significant investments with very small ventures, including tiny brokerage firms. Nor do they make clear whether the investments are merely indications of intentions or whether capital has actually been transferred. They also lump together the top 20 JVs which account for the lion’s share of capital with those 200 small to micro JVs. Even so, the aggregate numbers are extraordinarily small: as of 2011, the total number of joint projects stood at 245 (Graph 2.1). These 245 projects included 67 hotel administration contracts, eight production and service administration contracts, and 13 production cooperation agreements. Moreover, not all of these joint projects included private partners; some hail from Venezuela as the source country and presumably many of these projects engage not

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private investors but rather Venezuelan state-owned enterprises.\textsuperscript{30} Compare the number of JVs operating in Cuba with the number of foreign affiliates reported to be operating in other countries of roughly comparable size and development: 911 in Chile; 754 in Croatia; 5,387 in Ireland; 2,761 in Malaysia; 5,144 in Portugal; and 2,049 in Taiwan.\textsuperscript{31}

The number of joint projects in Cuba has been in sharp decline since 2002, when they peaked at just over 400, then fell by half by 2008. This consolidation occurred for several reasons. The Cuban state closed down many JVs, having concluded that they were either not living up to their original promises, were not advancing Cuban economic goals, were losing money, or were behaving illegally.\textsuperscript{32} Some firms withdrew upon finding it impossible to carry on a successful business within the context of Cuban state planning; firms entering during the heady reform years of the mid-1990s were taken aback when Fidel Castro decided to halt and even roll back some of those hopeful market-oriented measures. In some cases, Cuban state-owned enterprises did not welcome competition from private firms that had certain advantages, such as superior access to foreign credit and therefore to imported inputs, and so used their access to government agencies to squeeze the JVs; hapless JVs reported that their electricity rates or real estate rents suddenly spiked, gasoline was no longer delivered on time, visas were denied to international experts, access to critical foreign exchange was blocked, etc. Students of the political economy of state planning would not be surprised to hear of SOEs leveraging their political networks to disable private competitors.

In 1998, the Cuban government announced as a matter of principle that it preferred large-scale JVs to smaller ones.\textsuperscript{33} Apparently, this preference remains in place. Yet, this bigger-is-better prejudice flies against contemporary trends in international economic thought that argue the opposite: that small and medium-sized firms (SMEs) are often more innovative, more flexible, and employ more workers per dollar invested than very large firms. Nor is it necessarily an either/or proposition, as larger firms can benefit from being surrounded by efficient, specialized smaller suppliers. The Cuban government’s opposition to smaller JVs seems particularly odd at a time when it seeks to stimulate employment, increase the availability of consumer goods, and actively promote small-scale enterprise.

\textsuperscript{30} UNCTAD, (web Table 34, “number of parent corporations and foreign affiliates, by region and economy,” 2010), http://goo.gl/F6Gt1. These country numbers should be treated as rough orders of magnitude, as country reporting methodologies are not uniform and may understate quantities.


Joint Ventures: Employment, Sales, Exports

Citing internal government documents, Cuban sociologist Mayra Espina Prieto estimated that JVs employed 0.7 percent of the state’s 4.9 million person workforce—about 34,000 people. This rather small number seems plausible, considering that some of the larger JVs are located either in capital-intense mining and energy (Sherritt International) or in international marketing (Habanos, Pernod Ricard) whose sales forces are primarily located overseas and who do not directly employ the producers of tobacco or rum. Nor does this estimate take into account the large numbers of workers in hotels that are owned by Cuban SOEs but managed by foreign firms under hotel administration contracts.

Some JVs are strategically placed in the vital export sector. According to Cuban economist Omar Everleny Pérez Villanueva (based upon his access to unpublished data), JVs accounted for $1.9 billion in exports in goods and services in 2008. He attributed 80 percent of these exports to just seven firms.

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35 Email communication of Myra Espina Prieto with author, June, 2012.
Pérez Villanueva places these businesses in nickel, tobacco, citrus fruits, beverages, tourism, and communications, among others. Based upon our case studies and the high degree of industrial concentration, we can place names on these firms: Sherritt International (nickel), Habanos (British Imperial Tobacco, cigars), Havana Club rum (beverages), Rio Zaza and BM (citrus fruits), as well as Sol Meliá (tourism).

Further relying on unpublished government statistics, Pérez Villanueva presents data indicating that total JV sales in the period from 2007 to 2009 averaged $4.5 billion, including both exports and domestic sales (Graph 2.2). At $4.5 billion in sales, JVs would account for roughly seven percent of Cuba’s total production of goods and services, reported at $62 billion (2009).

Graph 2.2. Joint Venture Sales and Exports, 1992-2009 (U.S. Dollars, Millions)

Source: Omar Everleny Pérez Villanueva, The External Sector of the Cuban Economy. (Washington, D.C.: Woodrow Wilson International Center for Scholars, Update on the Americas, 2010), Figure 6. Table modified by author.
De Facto Excluded Sectors

Law 77 (Chapter IV, Article 10) allows for FDI in all sectors except health, education, and “the armed forces institutions, with the exception of the latter’s commercial system.” In practice, JVs have also been largely excluded from two sectors where foreign investors could make a huge contribution: sugar and biotechnology. In the case of sugar production, the obstacles appear to be rooted in revolutionary history. The expropriations of the large, often foreign-owned estates were a hallmark of the revolution; to return the land to foreign hands might seem an inglorious retreat. There is also the unresolved question of compensation to the former owners, necessary to free the lands from potential legal challenges by claimants and U.S. sanctions. Today, as officials reconsider FDI within the context of economic reforms, there is a sharp debate over whether and to what degree to further open food processing and agro-industry, including sugar-based biomass, to external capital. In an apparent victory for more favorable treatment for FDI, in late 2012 and after lengthy negotiations, the Cuban government approved a joint venture, Biopower, S.A., with British investors, to generate biomass from sugar derivatives; the roughly $50 million investment is to construct a 30 megawatt power plant. Billed as a pilot project, the British firm, Havana Power, hopes that other biomass energy projects will follow.

In the case of biotechnology, government officials voice fears that foreign partners will take advantage of Cuban firms and pirate their innovations. Rather than turn to the European and Japanese multinational pharmaceutical giants to assist in marketing Cuban innovations and pharmaceutical products, Cuba has preferred to seek state-to-state commercial deals with developing countries (notably Venezuela), and to attempt JVs abroad (notably in China), where Cuban firms are the foreign investors. Cuba has had some success with these strategies, but has had great difficulty accessing promising markets in Europe, Latin America, and much of Asia. Yet, it is the pharmaceutical multinationals that possess the requisite knowledge of national patent regimes and distribution networks which could take the Cuban biotech sector to another level of success.

Also largely excluded are financial firms, reserving a monopoly over most financial transactions to state-owned banks. A legacy of the Soviet planning model, capital markets are severely repressed in Cuba. Those international banks allowed to open representative offices in Cuba (Table 2.2) are generally restricted to international transactions that serve client needs.

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41 Also excluded in practice have been domestic and international commerce and legal consultancy. See Rolando Anillo, “Cuban Reforms and Foreign Investment Legislation: Knowing your neighbor and future partner,” Cuba Law Update, Fowler Rodriguez Valdés-Fauli, no date.
43 On joint ventures in China, see Julio A. Díaz Vázquez, China-Cuba: relaciones económicas 1960-2010 (Mexico, D.F.: Universidad Nacional Autónoma de Mexico, Cuadernos de Trabajo del CECHIMEX, 2011), Table 2, p.7.
Table 2.2. International Banks with Representative Offices in Cuba

<table>
<thead>
<tr>
<th>Bank Name</th>
<th>Country of Origin</th>
</tr>
</thead>
<tbody>
<tr>
<td>Havin Bank Ltd.</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>National Bank of Canada</td>
<td>Canada</td>
</tr>
<tr>
<td>BBVA</td>
<td>Spain</td>
</tr>
<tr>
<td>Banco Sabadell</td>
<td>Spain</td>
</tr>
<tr>
<td>Société Générale</td>
<td>France</td>
</tr>
<tr>
<td>Fransabank Sal</td>
<td>Lebanon</td>
</tr>
<tr>
<td>Caja Madrid</td>
<td>Spain</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>France</td>
</tr>
<tr>
<td>Republic Bank Ltd.</td>
<td>Trinidad and Tobago</td>
</tr>
</tbody>
</table>


FDI in Comparative Perspective

In countries roughly comparable to Cuba in size, or in those that share other similar characteristics, FDI flows have made substantial contributions over the last two decades. From 1990 to 2009, years in which Cuba was attracting roughly $3.5 billion in FDI, Costa Rica attracted $14 billion, the Dominican Republic $17 billion, and Chile $110 billion (Table 2.3). In Chile, the percentage of the population living in poverty had been cut in half during those two decades. With a population under 3 million and persistent political unrest and criminal violence, Jamaica attracted nearly $10 billion. Two pertinent Asian countries, Vietnam and Taiwan, attracted about $50 billion each. Socialist Vietnam retains a strong state presence in the economy and remains a one-party state. Taiwan, with a population of 23 million, is an island economy with a tense political relationship with its hegemonic neighbor. Ireland is also interesting, as it took advantage of its relatively well-educated workforce and access to European markets to attract over $110 billion in FDI. Also of interest to other developing countries seeking to attract high-tech FDI with proactive investment promotion policies is Malaysia, which attracted $90 billion, or $3,000 per capita (as compared to Cuba's roughly $300 per capita).

In nearly all developing countries, most savings and investment are domestic in origin; still, FDI can make a significant contribution. During the two decades from 1990 to 2009, FDI as a percentage of GDP equaled about 6 percent in Chile, 4 percent in Costa Rica, 3 percent in the Dominican Republic, 6 percent in Ireland, 5 percent in Jamaica, 5 percent in Nicaragua, and 6 percent in Vietnam (Table 2.3).

To its own detriment, Cuba has largely neglected an important source of badly needed capital. Let us imagine Cuba had allowed FDI inflows equal to 5 percent of its GDP (the average for the countries on Table 2.3) during the decade from 2000 to 2009, or roughly $2.5 billion a year.
In that scenario, Cuba would have absorbed some $25 billion—many times the existing JV capital stock accumulated over two decades. The associated technology, management skills, and access to export markets could have transformed the business climate, catalyzed an atmosphere of dynamic change, and elevated Cuba toward a sustainable growth path.

**Table 2.3. Inflows of FDI, by Country, 1990-2009**

<table>
<thead>
<tr>
<th>Country</th>
<th>Cumulative FDI (US$ billions)(a)</th>
<th>Inflows/GDP (percentage)(b)</th>
<th>Per Capita FDI inflows(c)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>110</td>
<td>5.7</td>
<td>6,532</td>
</tr>
<tr>
<td>Costa Rica</td>
<td>14</td>
<td>3.9</td>
<td>3,057</td>
</tr>
<tr>
<td>Croatia(d)</td>
<td>30</td>
<td>4.2</td>
<td>6,863</td>
</tr>
<tr>
<td>Dominican Republic</td>
<td>17</td>
<td>3.1</td>
<td>1,755</td>
</tr>
<tr>
<td>Ireland</td>
<td>113</td>
<td>5.8</td>
<td>25,013</td>
</tr>
<tr>
<td>Jamaica</td>
<td>10</td>
<td>4.9</td>
<td>3,528</td>
</tr>
<tr>
<td>Malaysia</td>
<td>90</td>
<td>4.4</td>
<td>3,231</td>
</tr>
<tr>
<td>Nicaragua</td>
<td>4</td>
<td>4.8</td>
<td>710</td>
</tr>
<tr>
<td>Vietnam</td>
<td>48</td>
<td>6.1</td>
<td>563</td>
</tr>
</tbody>
</table>

Sources:
(a) UNCTADstat. http://unctadstat.unctad.org/TableViewer/tableView.aspx
(Population is 2009 and FDI inflows are cumulative from 1990-2009)
(d) Data is available for Cumulative FDI from 1993, and FDI inflows as percentage of GDP from 1992.

**Missed Opportunities**

Summarizing these findings, we can conclude that FDI added about $3.5 billion to Cuban savings and investment over the last two decades or so, contributed handsomely to exports of goods and services, and accounted for roughly 7 percent of domestic output. JVs currently employ about 34,000 Cuban workers; or under 1 percent of the active labor force.

The flows of FDI to Cuba compare unfavorably to the experience of other countries, whether for countries of similar size and location in the Caribbean Basin or in high-growth East Asia. In Cuba, the joint venture sector is small in terms of numbers of productive firms and the number of Cuban workers they employ. Yet where foreign investors have been allowed to play a role—in key export sectors—JVs have contributed critically to Cuba’s economic survival. As we shall see in the case studies that follow, once permitted to operate, JVs can be successful in the Cuban context. But the Cuban government has driven a wedge—whether by directly denying business permits to operate or by indirectly discouraging investors—between Cuba and the vast ocean of savings circulating the globe and driving capital formation, technological diffusion, economic growth, and poverty reduction in developed and developing countries alike.
3. Case Studies of Joint Ventures in Cuba

In the United States and in many other countries, we benefit from large numbers of case studies of business organizations, both large and small, domestic and global. In addition to providing insights into management best practices, business case studies can tell us a great deal about how firms are adapting to the context in which they are operating, and about the business climate itself. For example, firms operating in a highly-competitive industry driven by rapid innovation will behave very differently from firms enjoying a protected market experiencing slow technological change. Firms facing a restrictive, regulated market will behave very differently from firms operating in a wide-open, free-market environment.

We have very few case studies of foreign firms operating in Cuba. Data are scarce and few scholars have been able to interview JV executives. To begin to fill this void, this publication contains seven case studies of leading JVs operating in Cuba. Sources include the published annual reports of the foreign investor; websites of the foreign and Cuban JV partners; author interviews (on a not-for-attribution, or background, basis) with foreign executives, investors, and diplomats; and other cited publications. In addition to making for colorful reading, the seven cases are intended to shed light on the policy environment in which JVs operate. The case studies reveal the special advantages and specific challenges that JVs face in Cuba and explore why some firms have succeeded while others have lost their licenses to operate. The studies also provide insights into how JVs perceive the current policy environment and where they would most like to see reforms. As a methodology, case studies are inevitably anecdotal, yet some of the findings are sufficiently robust as to suggest recommendations for future policy should the Cuban government decide it is in the national interest to attract more FDI.

The largest JVs operating in Cuba today, which account for the lion’s share of the stock of FDI as well as of the nation’s merchandise export earnings, are (in most cases) well-known global brands...
that have partnered with large Cuban state-owned enterprises. Most of the JVs were established in the 1990s, the heyday of Cuba’s opening to FDI, when Cuba allowed some foreign firms to obtain 50 percent ownership (or even majority shares) and, hence, management control.

There is another type of JV that has populated the Cuban landscape: not the established multinational but rather the individual foreign entrepreneur with an unusually strong appetite for risk. Among the list of top JVs, Sherritt International is the prime example of this type of business venture. Sherritt’s Cuban operations were the brainchild of a Canadian investment banker who cemented a strong personal relationship with Fidel Castro. Another partnership that, until 2010, would have been on a list of top JVs, Rio Zaza, was the creation of a Chilean exile-turned-entrepreneur and also a favorite of Fidel’s. However, Rio Zaza has since been seized by the Cuban authorities, making for a fascinating case study that shows the perils of political entrepreneurship. Yet even multinational giants are not immune to the shifting political currents in enigmatic Cuba, as the contested Unilever case underscores.

The seven case studies are of firms that are leaders in major sectors of the Cuban economy (Table 3.1). In the mining sector, Sherritt is the leading producer of Cuba’s most important merchandise export: nickel. Imperial Tobacco markets world-famous Cohiba cigars, exemplifying premium brand exports derived from Cuba’s agricultural produce (the French marketing giant, Pernod Ricard, distributes Havana Club rum, the distillate from sugar). A visible presence throughout the island, Sol Meliá, the Spanish hospitality chain, owns and manages many outstanding Cuban hotels and resorts. Four of the other cases (Nestlé, Souza Cruz, Unilever, Rio Zaza) distributed their top-selling consumer products in the domestic market.

Sherritt is also engaged in oil and gas. Not considered here are the petroleum production-sharing arrangements which may become important if exploratory drilling in Cuba’s special economic zone proves productive, but these are a different animal altogether in their corporate and capital structures. Also not considered here are state-to-state investments, of the sort established between Chinese and Venezuelan state-owned enterprises and their Cuban partners. They, too, are different creatures and there is insufficient information on the public record to permit much outside scrutiny.44

44 In the comprehensive IMF database on FDI, the Coordinated Direct Investment Survey, Venezuela does not participate and China does not release information on outward investment. China’s reported inward investment from Cuba was $53 million (2010). The most publicized Venezuelan investment is the Cienfuegos oil refinery, a 49/51 joint venture between the Venezuelan SOE PDVSA and its Cuban counterpart CUPET. An initial modest investment by PDVSA reopened the mothballed Soviet-era plant. An additional investment (variously estimated at between $2 billion - $4.5 billion) is planned to double capacity to 150,000 bpd by 2015, financed by Chinese loans guaranteed by PDVSA oil sales. Some Chinese construction equipment is on site even as the Cubans have balked at Chinese proposals to import large numbers of Chinese construction workers. Reportedly, the Chinese have reserved the option to purchase PDVSA’s 49 percent share. There is also talk of an associated petro-chemical complex including a fertilizer plant (but with 100 percent Cuban ownership).
Following the case studies, we will discuss general findings, including the advantages and disadvantages of operating within the Cuban system.

**Case Study 1: Sherritt International: Betting on Cuban Nickel**

In 1990, capping an 18-year career in investment banking in Toronto’s equivalent of Wall Street (Bay Street), Ian Delaney engineered a hostile take-over of the Sherritt Corporation—a publicly-listed old-line Canadian mining firm that had been a subsidiary of the Denver-based Newmont Mining Corporation. The aggressive proxy battle solidified his reputation as the “Smiling Barracuda” of Bay Street. At that time, Sherritt’s nickel refinery in Fort Saskatchewan, Alberta, was shut down for lack of raw material to process. Coincidentally, the Soviet Union was collapsing and its demand for Cuban nickel was slumping. In a daring strategic move, Delaney flew to Cuba, met with Fidel Castro and his ministers, and began negotiating a series of deals that would result in a 50/50

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45 Sources for this case study are Sherritt International Corporation, Annual Reports 2010, 2011; and Sherritt.com, unless otherwise noted. Figures are in Canadian dollars unless indicated otherwise.

JV between Sherritt and the Cuban SOE Compañía General del Níquel to operate the underperforming Moa mining complex in the eastern province of Holguín. In a reciprocal arrangement, the Cuban SOE was granted a 50 percent share in the Alberta nickel refinery. With these bold strokes, the Sherritt-Cuban partnership built a vertically-integrated mining, smelting, and marketing operation.

Figure 3.1. Ian Delaney and Raúl Castro (2007)

The operations of the Moa Joint Venture are carried on through three companies: Moa Nickel S.A., which owns and operates the Moa nickel and cobalt mining and processing facility; the Cobalt Refinery Company Inc., which owns and operates the Fort Saskatchewan, Alberta metals refinery; and International Cobalt Company Inc., which is responsible for the marketing of commodity cobalt and nickel.

Moa Nickel uses an open pit mining process to mine lateritic nickel and cobalt ore at its Pedro Soto Alba plant, which is processed onsite and shipped to the east coast of Canada. The minerals are then transported by train to Sherritt’s Fort Saskatchewan facility for refining into finished nickel and cobalt. Currently, the Moa Joint Venture produces approximately 37,000 tons of nickel and cobalt annually. From its 50 percent share in the Moa JV, Sherritt reported revenues of $483 million and net earnings of $126 million in 2011, contributing substantially to the corporation’s total revenues of $2 billion and net earnings of just under $200 million. A low-cost producer of nickel, the Moa JV reported a 2011 average net cash cost of nickel of $4.35 per pound, well below the annual average sales price of $10.14 per pound. The Moa JV sells its output worldwide (excluding the United States) and China is a major end-use consumer of Cuban nickel.

For Cuba, exports of nickel and cobalt from Sherritt but also from smaller, less efficient Cuban-owned operations, averaged nearly $1.5 billion from 2007 to 2009, accounting for over 40 percent of the island’s total merchandise exports (excluding services). Sherritt’s mining operations are absolutely vital to the survival of the Cuban economy.

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47 Archibald R.M. Ritter, “Canada’s Economic Relations with Cuba, 1990 to 2010 and Beyond,” Canadian Foreign Policy, Vol. 16, No. 1, (Spring 2010). Intrigued by the unusual deal, rumors circulate among Havana’s chattering classes that the Castro brothers themselves have a stake in Sherritt’s Alberta refinery.
Privileged Diversification

Building on the goodwill and trust that CEO Delaney garnered with the Cuban authorities, Sherritt has been granted concessions in an array of ventures across the island, even in some sectors where Sherritt had little or no prior business experience. (This pattern of privileged diversification we will see later when we look at the spectacular case of the once well-connected Chilean investor, Max Marambio, and his expansive business empire that included Rio Zaza.)

Sherritt’s oil and gas division produced an average of 20,888 barrels per day in 2011, contributing significantly to Cuba’s energy requirements. In Cuba, all oil production is sold to the Cuban government and Sherritt is allocated a share of oil production pursuant to its production-sharing contracts. Sherritt reported revenues from its oil and gas sales to the Cuban government at $287.1 million for 2011. Sherritt reported net income from company-wide oil and gas sales at $170 million, mostly from Cuban fields (Sherritt attributed 94 percent of its oil and gas production to Cuban operations). Looking ahead, Sherritt believes that there is potential for growth in Cuba’s oil and gas industry. The corporation plans to grow its production through ongoing development drilling and by implementing heavy oil recovery technologies proven in western Canada and other jurisdictions.

In addition, Sherritt holds an indirect one-third interest in Energas, a JV established to process raw gas that is then used to generate electricity for sale to the Cuban national electrical grid. The remaining two-thirds interest in Energas is held equally by two Cuban agencies, Union Electrica and CUPET (Cuba’s state-owned oil company). Sherritt provided the financing and technology for Energas’s gas treatment and power generation facilities located near the Varadero, Boca de Jaruco, and Puerto Escondido oil fields. The three facilities currently have a combined capacity of 356 MW, supplying a significant portion of Cuba’s electricity.

Sherritt operates the generation facilities under lease and service concession arrangements and is repaid from their cash flows. From its one-third share in Energas, Sherritt reported revenues of $54 million and net earnings of $12 million in 2011.

| Table 3.2. Sherritt International’s Cuban Operations, 2011 (Canadian Dollars, Millions) |
|--------------------------------|--------|---------|
| Mining (nickel/cobalt)       | 491    | 122     |
| Oil and Gas                  | 287    | 170     |
| Electricity generation       | 54     | 12      |
| **Total**                    | **$832** | **$304** |


In summary, Sherritt’s 2011 revenues across its cumulative mining, oil and gas, and electricity generation activities totaled $832 million and its net income $304 million (see Table 3.2).

But all has not been rosy for Sherritt in Cuba. In 2008, facing a severe foreign exchange
crunch, Cuba fell behind in payments on $161 million of Sherritt’s oil and gas and power receivables. The bulk of these arrears were rolled over into certificates of deposit issued by a Cuban government bank with a penalty interest rate of LIBOR plus 5 percent. In the event of default, Sherritt secured the right to receive payment from cash flows payable by the Moa JV, even as Sherritt insists that, notwithstanding delays and restructurings, in the end the Cubans have paid.

Some of Sherritt’s other ventures disappointed. In 1998, it acquired a 37.5 percent share of Cubacel, the cellular telephone operator in Cuba, for $38 million; despite achieving a positive cash flow, Sherritt resold this investment and the Cuban state has gradually assumed total control of the telecommunications sector. In the excitement generated by the opening of Cuba to international tourism, Sherritt acquired a 25 percent share of the Meliá Las Americas Hotel and golf course in Varadero and a 12.5 percent share of the Meliá Habana Hotel—both of which were managed by the Sol Meliá enterprise. However, both of these investments were divested in 2009 for about $14 million.

In 2006, Sherritt sold its 49 percent interest in a soybean processing business in Cuba for $43 million. The processing plant was dependent upon soybeans imported from the United States, such that the Cuban government may have been unhappy with its net impact on the balance of payments. Sherritt had warned that the business was performing “below expectations” and was having difficulty with distribution of and market development for its product within Cuba. Ultimately, Sherritt judged that the realized rate of return on investment was too low in light of the country risk.

Placing value on soy-based protein and food security, the Cuban government was a willing buyer. Sherritt Green, a 50/50 JV between Sherritt and an agency of the Cuban government, operated a small 200-hectare fruit and vegetable farm in the early 2000s. But after several years of enthusiastic notices, Sherritt’s 2007 Annual Information Form suddenly omitted Sherritt Green; facing management and logistical issues, the project was closed down.

Most damaging, in 2009, Sherritt saw a long-term oil production-sharing contract with the Cuban government and Sherritt’s Montreal-based partner Pebercan Inc. scrapped by CUPET, nearly 10 years before the contract’s termination date. Neither Pebercan nor the Cuban government gave reasons for CUPET’s action, although public documents indicate the SOE was well behind its scheduled payments. Reportedly, the Cubans argued that the JV had fallen behind certain commitments, and there were disputes over cost deductions. In the coercive settlement, Pebercan received a net lump sum

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50 Sherritt International Corporation, Annual Information Form 2009.
payment of $140 million from CUPET, $74 million of which was earmarked for Sherritt.\(^{53}\) While it’s difficult to evaluate the fairness of the deal, it reveals a pattern: when the Cuban state falls seriously into debt with an international partner, it may choose to close it down and wrap the arrears into a broader deal liquidating all assets. In that some compensation is offered and accepted, however grudgingly, Cuba escapes accusations of expropriation.

What the state gives, the state can take away. As Sherritt and other business cases demonstrate, foreign individuals and firms in good favor in Havana can gain privileged access to promising concessions. But as the Pebercan and Rio Zaza cases suggest, if the business turns sour, or if the CEO falls out of favor, the unsentimental Cuban state shows little empathy for former partners. Alternatively, as in the cellular phone business, the state may decide that business opportunities are just too promising to leave room for private competitors.\(^{54}\)

**Corporate Social Responsibility**

In conformity with Canadian business best practices, Sherritt maintains an active program of corporate social responsibility (CSR) in Cuba. The firm’s annual reports frankly acknowledge that these programs help the corporation maintain its social license to operate. Programs focus on social and physical infrastructure in the communities in which Sherritt operates, in cooperation with local Cuban authorities. Examples include street lighting and community sanitation, upgrades to senior housing and public schools, and the donation of materials to re-establish air conditioning in operating rooms at the main hospital in Moa. In other areas of CSR, such as worker health and safety and environmental stewardship, Sherritt’s recent annual reports appear consistent with best practices.

While the author has not attempted to rigorously evaluate Sherritt’s CSR program, informal conversations with Cubans revealed some awareness of the firm’s good corporate citizenship and former employees express satisfaction with the treatment they received from the Canadian investors. While no guarantee, the goodwill generated by a sustained, credible CSR program raises the costs to any government pondering predation.\(^{55}\)

**Helms-Burton: Sherritt Shows No Fear**

Prior to the 1959 revolution, the Moa mine had been owned by the U.S. Moa Bay Mining Corporation—now known as Freeport-McMoRan Copper and Gold Inc.—based in Phoenix, Ariz. In Novem-

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\(^{53}\) Sherritt International Corporation, *Annual Information Form 2011*.

\(^{54}\) Accounting for nearly half of national nickel production capacity of 75,000 tons, Sherritt shares the rich Holguin nickel fields with two SOEs, Che Guevara and Rene Ramos Latour. A new Cuban-Venezuelan joint venture, Cuba Quality S.A., has announced plans for a $US 700 million investment in a ferro-nickel plant, even as markets express heightened uncertainty about Venezuelan investment capacities.

ber 1996, eight months after the Helms-Burton Act was passed, Sherritt CEO Ian Delaney received a letter informing him that he was on a U.S. State Department blacklist. Along with all directors and senior officers of Sherritt International and their families, Delaney was denied entry into the United States. But Delaney and Sherritt were undeterred. In its annual reports, Sherritt notes that U.S. presidents have repeatedly waived Article III, which would authorize damage lawsuits to be brought in U.S. courts by U.S. claimants against those “trafficking” in the claimants' confiscated property. “Even if the presidential suspension were permitted to expire,” the corporation reassures its shareholders, “Sherritt does not believe that its operations would be materially affected by any Helms-Burton lawsuits, because Sherritt’s minimal contacts with the United States would deprive any U.S. court of personal jurisdiction over Sherritt. ... Management believes it is unlikely that a court in any country in which Sherritt has material assets would enforce a Helms-Burton judgment.”

Governments of Canada and the European Union, among others, have expressed strong objection to the extraterritoriality claims of Helms-Burton.

Sherritt concedes that the threat of potential litigation discourages some potential investors, lenders, suppliers, and customers from doing business with Sherritt. Nevertheless, the swashbuckling Delaney remains confident in his Cuban investment boasting, “We have an amazing book of assets right now in Cuba. We’ve still got 25-year nickel assets, 12-year oil assets, and 15-year power assets.”

Case Study 2: Habanos: Premium Brands

Who wouldn’t covet the exclusive rights to the global marketing of the legendary Cuban cigars? Consumers consider the Cuban cigar “the premium puro”—the world’s best cigar smoke. Like French wines, the Cuban cigar can be mimicked but cannot be authentically reproduced elsewhere: it is a unique je ne sais quoi blend of terroir (soil and climate), carefully cultivated seeds, a secretive blend of select tobacco leaves and wrappers, and patented processing techniques. Further, Cuban cigars are a lifestyle product, associated with sophistication and class, machismo and power (think Winston Churchill), and—with a little imagination—a blend of tropical sun, surf, and sex.

57 Pulcher (2009), op.cit.
58 Sources in this section are: www.habanos.com; Imperial Tobacco, Annual Report 2011; and author interviews, unless otherwise noted.
Initially, the Cubans came to the conclusion that while they had the product, they lacked the global reach of a major tobacco marketing conglomerate. Since Spain and France were major tobacco markets for Cuba, they sought out the Spanish-French firm, Altadis. In 2008, when Imperial Tobacco acquired Altadis, the CEO of Imperial Tobacco immediately flew to Havana to reassure its new Cuban partners of the British firm’s strong interest in its Cuban acquisition. For even though Cuban tobacco accounts for a small percentage of Imperial Tobacco’s annual revenues, it is valued as a prestige brand that adds glow to the firm’s entire portfolio: Imperial Tobacco’s accountants value the “goodwill” of its Cuban cigar venture at £291 million. The world’s fourth largest cigarette company, Imperial Tobacco ranks number one as the largest producer of cigars.

In a 50/50 JV, Imperial Tobacco reports good working relations with its Cuban partner, Cubatabaco, which takes responsibility for the supply chain—from the tobacco farmer through the manufacturing process. Imperial and its Cuban partner evenly split the two co-presidencies and four vice presidencies, even as the Imperial vice presidents take responsibility for the strategic finance and business development portfolios. Imperial emphasizes that all key decisions are taken by consensus and that both sides, pursuing common goals, take a win-win approach toward management decision making. Habanos participates in an industry “regulatory council,” whose membership includes Tabacuba, the world-renowned Tobacco Institute, and the National Association of Small Farmers, whose members plant the tobacco. Working together, the Cuban tobacco industry seeks to maintain standards, plan annual production, and innovate new products. While the basic product, the cigar, may seem stable, new styles in terms of shapes, sizes, and blends are continuously being designed and launched. Imperial, with its deep immersion in international markets, is well positioned to assist its Cuban partners in keeping abreast and ahead of market trends.

With $400 million in revenues as of 2011, the Habanos joint venture has maintained a steady annual growth rate of 7 percent or better. For 2011, Imperial Tobacco reported that Habanos S.A. realized £35 million in profits on net assets of £194 million. Habanos has attained or surpassed all of the key performance indicators (such as sales, market share, and profits) agreed upon in the joint venture contract and annual plan updates.

The basic economics works for both JV partners. For Imperial, the direct labor component of 250 Cuban employees contracted through a government labor entity—despite augmentation from high government labor taxes—is pleasantly small when measured as a proportion of the cost of production or, especially, of final sales. The Cuban partners take responsibility for purchasing tobacco from the artisan farmers, many of whom retain small, private acreage from

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59 Imperial Tobacco Group, PLC, Annual Report and Accounts 2011, p. 97.
pre-revolutionary days, while other farmers received their lands courtesy of the revolution. For
the Cuban partners, the net foreign trade ratio is highly favorable: imports are a minor factor in
production costs, while most of the output is sold overseas (or if sold in Cuba, in CUC shops).60
Imperial takes responsibility for assuring international liquidity and secures lines of credit from
foreign banks. The Cuban partners are also entitled to half of the profits.

So far, Habanos’s sales are a minor contribution to Imperial Tobacco’s annual revenues of £29.2
billion. Looking ahead, Imperial’s 2011 annual report takes note of “excellent momentum” in the
emerging markets of Brazil, Russia, and China. At the moment, Imperial Tobacco assiduously bracket-
ets its Cuban operations from its U.S. activities and its Havana-based executives stay clear of U.S.
airports. But the firm is well positioned to surge into the United States—which accounts for some
80 percent of the market in premium cigars—once U.S. economic sanctions are dismantled. As an
executive with another major marketing multinational remarked to the author, “Everyone in the
consumer goods industries knows that eventually Cuban products will sell at a price premium in
U.S. markets.” When that smokin’ day comes, Imperial Tobacco stands ready to provide the invest-
ment capital to boost cigar production by 50 percent in five years. Cuba has plenty of tobacco-
friendly terroir to satisfy the demands of U.S. cigar aficionados.

Despite its good relations with the Cuban government and its commercial success, Habanos S.A.
has not escaped from the broad brush of Raúl Castro’s anti-corruption campaign. In 2010, Ha-
banos’s highly visible commercial vice president, Manuel Garcia, and 10 of his staff were accused
of pilfering genuine cigars and selling them at a fraction of their normal price to black-market dis-
tributors in return for bribes.61 But the sudden removal of these seasoned distributors does not
seem to have materially impinged on the commercial performance of the JV.

Case Study 3: Sol Meliá: International Hospitality62

“Cuba Con Todos Los Sentidos” – Sol Meliá slogan

There’s no escaping geography: International tourism is Cuba’s overriding comparative advantage.
Because tourism had become so closely associated with immorality and imperialism, the 1959

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60 According to one informed source, 90 percent of Habanos sales are accounted for by exports. Emilio Morales and
Joseph Scarpaci, Marketing without Advertising: Brand Preference and Consumer Choice in Cuba (Routledge, 2012),
chapters 5-6.


62 Sources for this case study include: Sol Meliá, Sustainability Report 2010, (Havanatur, Catalogue, no date); Hosteltur,
and author interviews.
revolution largely shut it down. Yet beginning cautiously in the 1980s and then accelerating after
the loss of Soviet subsidies, Cuba re-opened its beaches to foreigners seeking tropical sun and surf.
Cuba turned to European and Canadian hotel chains and tour operators who could help to build
and manage hotels and organize tour packages and air transportation to ensure a steady stream
of vacationers. For Canadians, Russians, and other Europeans of modest means, Cuban tourism
offered good value and a relaxing week or two in a beautiful, warm, and secure destination. Cuba
welcomed 2.7 million international visitors in 2011, up from 2.5 million in 2010; 2012 looks to be an
even stronger year.\textsuperscript{63} International tourism contributes significantly to Cuba’s balance of payments,
generating over $2.2 billion in hard currency revenues as of 2010.\textsuperscript{64}

\textbf{Figure 3.3. Meliá Habana – Five Stars}

Among the international hotel chains called upon
to enter into JVs or management service con-
tracts, the Spanish firm Sol Meliá has been the
leader. As of 2010, it was engaged in 27 properties
in Cuba (out of a worldwide total of 310), divided
among four brands each appealing to different de-
mographics or price points: Sol, with 10 properties,
offering all-inclusive vacations for middle-income
families; Tryp by Wyndham with three “functional”
properties; Meliá with 11 for business travelers, in-
cluding the urban Meliá Habana and Meliá Cohiba; and Paradisus with three upscale resort hotels.
Sol Meliá operates some of these properties as JVs with one of the major Cuban government hotel
groups. In the majority of cases, Sol Meliá has entered into management service contracts (Con-
tratos de Administracion Hotelero) with the Cuban owner. On such properties, Sol Meliá earns
management fees that include a “basic fee” and an “incentive fee” based on performance.

A survey completed in the mid 2000s of executives of international hotel chains active in Cuba
agreed that the Cuban tourism industry has produced above-average gross operating profits in
most hotel groups, including Sol Meliá. The study reported that “the island has consistently been
Sol Meliá’s most profitable market during recent years.”\textsuperscript{65} The study also noted that some hotel
operators preferred service contracts rather than direct investments in order to minimize risk ex-
posure in the Cuban market.

\textsuperscript{63} ONE, Repúblico de Cuba, “Tourism: arrival of international visitors – September 2012.”
\textsuperscript{64} ONE, Repúblico de Cuba, (External Sector, 15.11, “Tourism hard currency revenues”), http://www.one.cu/aec2010/esp/08_
tabla_cuadro.htm.
\textsuperscript{65} Julio Cerviño and Jose Maria Cubillo, “Hotel and Tourism Development in Cuba: Opportunities, Management Challeng-
Sol Meliá is quite happy with its Cuban workforce: educated Cubans flock to employment in the tourist industry where they hope to gain access to tourist dollars, whether via hard-currency bonuses from their employers or from tips from generous tourists. In the hiring process, the employment entity of the Ministry of Tourism (MINTUR) makes the first cut and then presents a list of candidates from which Sol Meliá can make its selections. The government subsidizes the training that hotels provide to their employees. For that purpose, Mintur receives financial transfers from the ministries of labor and of social security.

Figure 3.4. Tryp Península Varadero (Gaviota ownership, Sol Meliá management)

The median worker costs Sol Meliá about $900 per month, taking into account all expenses, including wages and bonuses, benefits, taxes, transportation, and food. This wage bill consumes about 27 percent of revenues—less than in Spain but significantly more than in the Dominican Republic. According to some sources, the higher cost of labor in Cuba as compared to neighboring locations compels Cuban hotels to hire fewer workers per guest, which impacts negatively on the quality of customer service.

Many Cuban firms, both JVs and SOEs, pay a portion of profits into a Stimulus Fund for employee bonuses, which can amount to as much as 30 percent of base salary (and reportedly more in some cases). The Ministry of Economy and Prices (MEP) negotiates the nature of Stimulus Funds with each sectoral ministry (such as MINTUR). For the tourism sector, firms pay 3 percent of profits into their Stimulus Fund. If there are no profits in one period but superior profits in another period, extra payments from the second period can compensate for the shortfall in the first period. Some JVs report that pay-outs from their Stimulus Fund are rather automatic, negating the goal of serving to stimulate performance. Some firms claim that their unions control the funds and simply distribute them equally among the employees, perhaps channeled by the political agenda or favoritism of union leaders. Sol Meliá distributes its Stimulus Funds by the following formula: 50 percent according to disciplinary performance (i.e., attendance, absence of pilferage) and 50 percent according to cost efficiency and client satisfaction. Stimulus Funds that are paid in hard-currency CUCs—as is the norm in the tourism sector—are much more enticing to workers than those that pay in national currency.

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66 A mid-2000s study reported monthly salaries for hotels at $300-1500 per month. Ibid, p.19.
The efficiency goals of President Raúl Castro are impacting the tourism sector. Earlier emphasis on employment creation—which was consistent with the national goal of full employment—has given way to a greater focus on cost containment. As a result, Sol Meliá has engaged in staff reductions. Hotel operators are also pleased at recent reforms in national labor practices, which have made it easier to hire part-time workers.

A chronic headache for hotels operating in Cuba has been reliability of supplies. For vital imports, JVs have the advantage where the foreign partner has ready access to external lines of credit. Most hotels have to rely on the annual import budget of the Importadora del Turismo Hotelero (ITH), a dependency of MINTUR. ITH receives priority in the annual budget allocations—since tourism is such a critical generator of foreign exchange earnings—but its resources are constrained by the nation’s overall hard currency position. Hotels are also affected by decisions made by other Cuban government agencies (e.g., the allocations of scarce fuels and the recent sharp increases in electricity prices).

Irregularity in deliveries from domestic suppliers is another chronic headache. Hotels have long complained about the reliability and quality of farm products provided by FrutaSelecta, a MINTUR distributor. As a pilot project, the government has begun allowing some farm cooperatives to sell directly to hotels, who have welcomed the marked improvement in the variety and quality of fruits and vegetables (although transportation bottlenecks persist). Some hotels have also been allowed to directly hire self-employed workers for certain tasks, including construction and landscaping.

The quality of many local products remains a problem. To conserve foreign exchange and generate local employment, the government presses hotels to source locally, but hotels resist where and when poor quality would jeopardize customer satisfaction. For example, one hotel that caters to business executives refused the local producer of towels and linens in favor of higher-quality imports.

Hotels operating in Havana are benefiting dramatically from the recent surge in tourism from the United States, reaching some 400,000 Americans in 2011—more than double the flow of tourists in 2009.67 In response, occupancy rates and room rates have been rising. Especially welcome are those Americans participating in the people-to-people programs (distinct from Cuban-Americans visiting their families) licensed by the Obama administration: These visitors tend to be, in the

words of one hotel operator, “gente de nivel” (higher-class travelers) as compared to the typical European or Canadian seeker of sun and surf.

Assuming that the surge in U.S. visitors continues, the big challenge for Cuba is to build the accommodating hotels and other tourist-related facilities. Always short of resources, the Cuban government has regularly fallen well behind stated goals for constructing additional room capacity. Yet, the government seems reluctant to allow foreign investors to take equity shares in new ventures. As of 2009, there were 65 hotel administration contracts—accounting for half of total hotel rooms—but only 14 hotels operating as JVs.68 Mintur and its associated tourism conglomerates (Cabanacan, Gran Caribe, Gaviota, and Islazul) prefer to retain ownership and control, and to limit foreign participation to management service contracts. According to a knowledgeable source, one international chain already active in Cuba offered $15 million to refurbish a major hotel property in return for equity, but MINTUR has demurred. Meanwhile, major international chains, including Sol Meliá, Iberostar, Barceló, Sofitel, and Sandals are reportedly interested in investing more in the expanding Cuban market, as are some lesser-known investor groups. Many elaborate plans are on the drawing board—some even visible on the Internet—poised to build golf resorts and boating marinas all over the island. One source counted 16 proposed golf courses at an estimated cost of $1.5 billion.69 Some would-be investors have publicly trumpeted their belief that MINTUR approval is imminent.

If the Cuban government has a viable plan to accommodate a surge in tourism from the United States, it has not been made public. Nevertheless, international hotel chains such as Sol Meliá see a bright future in Cuba. They are more than willing to continue to supply management expertise, but they would also like to take equity positions. Given the scarcity of foreign exchange hampering Cuban economic development and the construction industry in particular, equity partnerships would seem to be a reasonable bargain for all parties.

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Habana Vieja: Mission to Accomplish

The massive, inspiring Habana Vieja (Old Havana) was once upon a time the architectural jewel of the Spanish Empire in the Americas. Having fallen into deep decay, it has been undergoing a respectful but painfully slow renovation. The renovations of its sister colonial old towns in Cartagena, Colombia; San Juan, Puerto Rico; and Panama City, Panama—while admittedly smaller in scope—have proceeded much more rapidly. Eventually, Habana Vieja will return to its former glory, reborn not as an entrepot for the transshipment of precise metals and African slaves, but this time as a cultural-historical destination for tourists from around the world. A rush of visitors is likely to descend upon Cuba over the coming decade, and Habana Vieja should be ready to profit from the influx.

To accelerate the renovation of Habana Vieja and to better match the ambitious aspirations of city planners with financial resources, Cuban authorities need to reconsider their attitudes toward private investment, from both international and Cuban sources. Of course, building permits should conform to renovation plans that preserve the historical legacy.

Here are some acceleration measures, most of which are aligned with the 2011 economic guidelines, for Cuban authorities to consider:

- Extending a warmer welcome to international investment in hotels and allowing foreign firms to hold equity shares as wholly-owned as well as joint venture enterprises.

- Encouraging hotels and other enterprises—whether government-owned or private—to contract services from small-scale private firms, ranging from IT professionals to construction teams, which are flowering under the 2011 economic guidelines.

- In allocating retail space, giving preference to local artisans and designers as opposed to international luxury brands, in order to build a tourism industry with backward linkages generating employment throughout the Cuban economy.

- Revamping the regulations governing the performing arts, such as liberalizing entrance fees and facilitating payment of a living wage to actors and musicians, to transform Havana into a vibrant showcase city for Cuban artistic talent.

- Inviting larger-scale international cooperation from foundations, multilateral agencies, and private donors to become important partners in creating an innovative, prosperous, and magnificent 21st century Havana.
Case Study 4: Nestlé Ice Cream/Coralac

“Nestlé’s unmatched geographic presence is one of its competitive advantages. From Swiss beginnings, the company grew to establish a presence in almost every country in the world. Today, Nestlé’s presence in most markets, including emerging markets, dates back many generations, and in some cases more than a century. This has created very close relationships between our brands and consumers, as well as a deep understanding of local needs and trends wherever Nestlé operates.”

Nestlé, the Switzerland-based food and beverage giant, remembers when pre-revolutionary Cuba ranked among its top five markets in Latin America and the Caribbean. Founded in 1867 and with a 21st century strategic vision of “Nutrition, Health and Wellness,” Nestlé has a long-term view of the Cuban market. Nestlé wants the Cuban consumer to associate its brand name with “Good Food, Good Life,” guaranteed quality, and fun flavors. When the Cuban market eventually becomes more open and other global marketing firms are allowed to compete, the Cuban mind will already have been conditioned to select the Nestlé brands.

Interestingly, Nestlé has found that the relatively well-educated Cubans carefully read nutrition labels—more so than consumers in other middle-income countries. Nestlé’s dairy division believes that ice cream, a product that delivers both nutrition and pleasure, is a natural for the Cuban market.

Nestlé regularly launches new products at the annual Havana International Fair. In 2010, it captured its fifth consecutive Gold Quality Medal with the launching of “Dolce Vita”—caramel popsicles coated with flavorful almonds (Figure 3.5, top left corner).

The company runs two JVs in Cuba: Coralac, the ice cream maker and distributor, and Los Portales, the bottler of mineral water. Los Portales markets the brand names “Los Portales” and “Ciego Montero,” whose plastic containers are visible

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70 Sources for this section include: Nestlé, Annual Report 2011 (2011); Coralsa website, www.coralsa.com.cu; and other cited publications.

everywhere on the island. Both JVs partner with the Cuban government company, Corporación Alimentaria, S.A., or Coralsa. Nestlé holds a 50 percent share in Los Portales (with a capital of $24.1 million) and a 60 percent share in Coralac (with a capital of $6.4 million). Both firms fall under the jurisdiction of the Ministry of the Food Industry (Ministerio de la Industria Alimenticia, MINAL).

Coralac enjoys a dominant market share in the hard-currency CUC market for ice cream products. Acting as a gatekeeper, the Cuban government limits the number of foreign brands that are allowed to enter the island and that might compete with Nestlé’s ice cream. Several state-owned firms compete in the domestic currency market, such as the highly renowned—and heavily subsidized—Coppelia brand. Yet some Cuban consumers remark that the quality of Coppelia ice cream has declined, perhaps for lack of new investment in plant and equipment;72 these consumers now aspire to Nestlé ice cream, a special treat for Cubans without access to CUCs. Nestlé can look forward to the day when, upon unification of the dual currency regimes and an upward adjustment in wages, it sells its popsicles to all Cubans at competitive prices.

Coralac has achieved a consistent, if modest, growth in sales over the last decade, but its annual revenues are de minimus when measured against Nestlé’s global sales of CHF 83.6 billion and profits of CHF 12.5 billion (2011). However, Coralac’s profitability has been in line with its parent company’s global performance. One financial plus of operating in Cuba is that there is little expenditure on conventional advertising: the state-run media eschew corporate ads and roadside billboards are reserved for political messaging. Nestlé does brand its trucks, ice coolers, and wrappers; a consumer survey (2006) found that in the food category Nestlé was the most recognized foreign brand in Cuba.73

Coralac lives with the advantages and frustrations of a socialist system. In a market highly regulated by the government, the prices of Coralac’s inputs and outputs are set within the state’s annual plan. Prices are based on cost sheets for each product and any changes require approval by the Ministry of Finance and Prices, although price promotions are generally prohibited.74 In effect, Coralac’s profit margins are set in this formal negotiating process. Coralac’s profits are in large measure set by this extra-market bargaining, and, hence, are predictable and relatively stable.

As is true for many producers in the Cuban context, Coralac faces prices that are fixed by a government determined to restrain inflation and, hence, very reluctant to grant price increases. But there

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72 Coppelia has had to reduce its offerings of flavors because of high production costs and negative earnings. Emilio Morales and Joseph Scarpaci, op.cit., Chapter 6.
73 Emilio Morales and Joseph Scarpaci, op.cit., Table 3.3.
is a path around the inertia of existing prices. Coralac’s factory produces more than 20 flavors of ice cream; by innovating new products whose first-time prices may be set higher, firms can try to elevate their profit margins without necessarily impacting the consumer price index (which captures prices on an existing bundle of consumer items). Not surprisingly, each year, Coralac spins new products into the Cuban marketplace.

Nestlé prides itself on quality control and, hence, wants its local suppliers to meet its global standards. Coralac, therefore, audits all of its suppliers. However, Coralac’s ability to structure its supply chain is constrained by the government’s direct control over the national dairy industry. In its global operations, Nestlé typically engages deeply into upstream production, working with local farmers by providing training and expertise in milk supply, technical equipment, management and finance. In Cuba, however, Nestlé is impeded from implementing its global “Creating Shared Value” strategy of collaborating closely with suppliers and with their rural communities. Therefore, the Cuban dairy industry is denied the full benefits of Nestlé’s expertise in supply chain management. Cuban centralism inhibits Nestlé from diffusing its proven technological know-how throughout the local economy.

Although Nestlé holds a majority stake in Coralac, decisions are taken collegially and by unanimity; at a general level, there is agreement on the goals of “sustainable growth.” There may be more subtle differences, however, between the two partners. Nestlé’s global market culture focuses on the consumer and brand loyalty, whereas the Cuban partner, Coralsa, prioritizes employment creation and cost reduction—two goals which may be in conflict. The JV partnership encourages Cubans to think less in terms of material balances and input-output matrices and more in terms of consumer welfare.

For foreign investors such as Nestlé, partnering with a Cuban government agency entails both benefits and challenges. At times, Coralsa can carry Coralac’s water, in negotiations with other government agencies whose powers impinge upon the joint venture’s business operations. But Coralsa’s loyalties run in two directions: from the JV to the government, but also from the government to the JV. The government has its universal goals—conserving energy, reducing imports, and expanding exports—which must apply to the ice cream industry and Coralsa will seek to insert them into the JV.

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75 Emilio Morales and Joseph Scarpaci, op.cit., Chapter 6.
76 A recent questionnaire survey of Cuban business executives, some working for JVs, confirmed that JVs focus more attention on marketing. Julio Cerviño, Joan Llonch, and Josep Rialp, “Market Orientation and Business Performance in Cuban Firms: A Comparative Analysis of State-Owned Versus Joint Venture Cuban Firms,” presented at the Association for the Study of the Cuban Economy (ASCE) annual meetings, 2012, Miami.
Like all JVs, Nestlé must live with the labor system that governs foreign investment, in which workers are hired via a state employment entity. While the employment entity often assigns good workers, its priorities may not be fully aligned with those of the JV. The wage and performance guidelines set by the state limit Coralac’s flexibility in establishing employment packages and incentive structures. Driven by the revolution’s commitment to social equity, wage differentials among employment categories are narrow. JVs report many cases where promising employees decided to turn down promotion offers: “Why should I take on more responsibilities and headaches and possibly longer hours, when the increase in wages is so small?”

Recently, in response to charges that workers in JVs were becoming a new “labor aristocracy,” the government forced JVs to reduce expenditures on employee lunches (from $2.50 to $1.50 per day), to the detriment of employee morale.

Nestlé looks forward to currency unity, confident that it will be able to compete successfully against national brands that currently serve the local currency market. However inflation, which is likely to be a by-product of currency unification, is a worry, as it could shrink consumers’ purchasing power. Another impending challenge to the firm: an expanding private sector offering a wider range of consumer choices that will compete with foods and beverage.

Case Study 5: Brascuba Cigarrillos: Serving a Protected Consumer Market

Maybe it’s the sunny Brazilian personality, but Brascuba Cigarrillos S.A.—the very first JV established under the 1995 foreign investment law—is unabashedly upbeat about its business and its ability to maneuver successfully in the Cuban environment. Of the more than 300 employees, only two of the managers are Brazilian nationals, but their buoyant personalities may be infectious. Or maybe it’s the esprit d’corps of Cuba’s tobacco industry, proud of their brand and its fame on global markets. Or maybe the confidence that comes from knowing that the Cuban and Brazilian governments enjoy warm diplomatic relations.

Brascuba is a 50/50 joint venture between the Brazilian cigarette company Souza Cruz, which in turn is owned by the U.K.-based British American Tobacco (BAT), and the Union of Tobacco Companies of Cuba (TabaCuba), a state-owned monopoly and dependency of the Ministry of Agriculture (MINAGRI). Brascuba’s factory workers transform Cuban tobacco into cigarette

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77 In their study of the tourism industry, Cerviño and Cubillo similarly found that “because there is little opportunity for financial gain, general managers find it difficult to motivate staff to take on additional responsibility or do jobs to the best of their ability.” Op.cit., p.20.

78 Souza Cruz is BAT’s largest subsidiary. BAT, along with Imperial Tobacco, Philip Morris, and Japan Tobacco, are the four biggest tobacco companies. See “Interview of BAT CEO Nicandro Durante: the running man of Big Tobacco,” Financial Times, October 1, 2012, p.14. Durante is Brazilian.
brands that command 99 percent of the hard-currency CUC market (although a much smaller share in the more competitive domestic currency markets).\footnote{According to one source, Brascuba began in the following manner. In 1995, with an initial investment of $7 million, Brascuba renovated an existing cigarette factory in Havana and started producing and selling several brands of cigarettes for both the foreign and domestic markets, where it had to compete with SOEs. Then, in 1999, Brascuba negotiated a new agreement with the Cuban government that practically gave Brascuba the monopoly on cigarettes in the domestic hard currency and export markets. In return for this, Brascuba helped finance an SOE-owned cigarette factory in Holguin producing for the local currency domestic market. Spadoni, “Foreign investment in Cuba,” op.cit., p.167, fn. 36, citing an interview with a news correspondent stationed in Havana.}\footnote{Morales and Scarpaci, op.cit., chapter 6.} Brascuba exports 10 to 15 percent of its production.

Brascuba has experienced steady growth since its inception, using 5,000 retail outlets across the island, and is widely regarded as one of the most successful JVs.\footnote{With an annual revenue of $32 million in 2011 and a positive operating profit, which is divided evenly between the two partners, Souza Cruz is satisfied with its performance—even as its profitability falls short of BAT’s global standards. Brascuba’s profitability is capped by the prices for cigarettes as set by the Cuban government, which—as of 2011—had not been increased since 2004. The firm identifies these government-imposed price ceilings as its biggest challenge. With its modest profits, Brascuba cannot invest in expanding production capacity as rapidly as it would like. As with many JVs, when asked what each partner brings to the bargain, Brascuba answers: the foreign partner provides investment capital, technology, employee training (including in Brazil for some Cubans), exclusive brands, access to international markets, and international lines of credit. In comparison, the local partner provides the land, the buildings, the workers, and, in the case of TabaCuba, an assured supply of quality tobacco and Cuban cigarette brands (Cohiba, U. Upmann). As a government entity, TabaCuba also provides channels to government ministries that help resolve problems as they arise. Indicative of its long-established working relations with the Cuban authorities, Brascuba’s two Brazilian executives also enjoy direct access to senior officials in relevant government ministries.} With an annual revenue of $32 million in 2011 and a positive operating profit, which is divided evenly between the two partners, Souza Cruz is satisfied with its performance—even as its profitability falls short of BAT’s global standards. Brascuba’s profitability is capped by the prices for cigarettes as set by the Cuban government, which—as of 2011—had not been increased since 2004. The firm identifies these government-imposed price ceilings as its biggest challenge. With its modest profits, Brascuba cannot invest in expanding production capacity as rapidly as it would like. As with many JVs, when asked what each partner brings to the bargain, Brascuba answers: the foreign partner provides investment capital, technology, employee training (including in Brazil for some Cubans), exclusive brands, access to international markets, and international lines of credit. In comparison, the local partner provides the land, the buildings, the workers, and, in the case of TabaCuba, an assured supply of quality tobacco and Cuban cigarette brands (Cohiba, U. Upmann). As a government entity, TabaCuba also provides channels to government ministries that help resolve problems as they arise. Indicative of its long-established working relations with the Cuban authorities, Brascuba's two Brazilian executives also enjoy direct access to senior officials in relevant government ministries.

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The Cuban government wants Brascuba, like other established JVs, to improve its contribution to the balance of payments, by importing less and exporting more. Thus, the firm plans to substitute domestically-manufactured cigarette filters for imported ones. Making use of BAT’s global marketing machine, Brascuba already exports its cigarettes to over 10 countries, including Germany, Spain, Brazil, Mexico, and Japan. However, it is struggling to hit the 20 percent exports and total output target set by the government without cannibalizing markets already served by other BAT production facilities.81

A manufacturing firm, Brascuba is very concerned with the quality and cost of its labor force. As is the case for all JVs, Brascuba must select from among a list of eligible workers pre-sorted by a government employment agency. Wage rates, set by a government salary scale, are permitted to vary only within a narrow band. Social equality rather than labor productivity remains the main driver of wage differentials. Brascuba does offer a monthly bonus, whose terms and conditions are negotiated with the Ministry of Agriculture. The established performance targets are set such that workers typically fulfill them and hence can anticipate receiving their bonuses—which by accounts from Brascuba employees can equal or even exceed their base pay. Proportionally, these bonuses would exceed those reportedly authorized in other sectors, such as tourism (see case study of Sol Meliá). However, although the bonuses are significant in size and may serve to improve employee morale and reduce labor turnover, automatic payments are not optimal for incentivizing productivity.

Brascuba considers that motivating and retaining talent is one of the firm’s key challenges. Beyond bonuses, the firm can offer some amenities, such as transportation, medical facilities for employees and their families, modest improvements in dining facilities, and opportunities for the employees to engage in conversations over coffee with senior management. An important stimulus is career promotion and training. For some managers, this includes trips to Brazil, where they are exposed to the expertise and procedures of Souza Cruz and the parent firm, British American Tobacco; Brascuba managers take pride in their knowledge and application of high global standards of operation.

For a consumer market firm like Brascuba, the economic reform process presents a mixed picture. Brascuba would applaud currency unification because it would create a unified consumer market wherein it could sell its cigarettes; and reduce labor costs—assuming the lifting of the implicit heavy tax on labor levied by today’s split currency system. A system of more flexible prices would be especially welcome, although, on the downside, economy-wide price adjustments that eat

81 On the impact of smoking on public health, especially in developing countries, see Cheng Li, The Political Mapping of China’s Tobacco Industry and Anti-Smoking Campaign (Brookings Institution: Washington, D.C., 2012).
into consumer purchasing power could hit cigarette purchases. Overall, this Brazilian-Cuban JV has reason to feel confident that it could compete successfully in a more liberal market environment.

Finally, Brascuba estimates that U.S. economic sanctions raise its costs of doing business by some 20 percent. Inputs such as cigarette filters, manufacturing equipment and spare parts, and infrastructure such as information technology, must be sourced from more distant and perhaps less cost-efficient sources. Unexpectedly, Brascuba links the unwelcome emigration of skilled workers, whether departing to the United States or elsewhere, to U.S. economic sanctions.

Case Study 6: Unilever: Ouster of a Marque Multinational?82

With annual revenues of €46.5 billion and €6.4 billion in operating profit as of 2011, Unilever, together with Proctor & Gamble and Nestlé, are the world leaders in personal and home care products. Unilever markets such diverse name brands as Dove soaps, Lipton teas, and Hellmann’s mayonnaise in over 190 countries worldwide. Unilever’s multiple research and development facilities spew forth a continuous stream of innovative products to bolster its portfolio of hundreds of differentiated “solutions.” With its bi-national Dutch and British management, Unilever prides itself on its ability to operate in virtually every political environment in the world. The giant conglomerate is frequently recognized for its good corporate citizenship. As an example of its responsiveness to contemporary trends, by 2020 Unilever promises to source all of its agricultural materials in a sustainable manner.

In 1994, Unilever formed a 50/50 international economic association with Suchel, a state-owned company operating under the Ministry of Light Industry (Figure 3.8), which specializes in personal and home care products, including soaps and detergents. The Suchel Lever JV has produced and marketed Unilever brands such as Lux soap and Pepsodent toothpaste. With annual sales from 25 to 30 million euros and market shares of 50 to 60 percent in the hard-currency CUC market, Unilever had been pleased with its Cuban investment. In the grand schemes of things, however, Unilever’s Cuban operations were not worthy of listing in the corporation’s annual financial statements: “those companies not listed are not significant in relation to Unilever as a whole.”83

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82 Sources for this case study include: Unilever, Annual Report and Accounts 2011 (2011); Suchel Camacho website, www.suchelcamacho.cu; and author interviews.
83 Unilever, p.109.
Unilever’s multiple motives for operating in the modest Cuban market included: implanting corporate brand names in the minds of the Cuban people and gaining a beachhead in the Cuban market anticipating long-term growth, advancing the corporate mission of a universal presence, and obeying the competitive imperative of denying market shares to its major rivals. In Cuban markets, however, Unilever had concentrated on personal and home care products whereas Nestlé sells foods and beverages. This is a more comfortable arrangement which avoids head-to-head competition between the two conglomerates. Both Unilever and Nestlé gained a running start on Cincinnati, Ohio-based P&G and New York-based Colgate-Palmolive, excluded by U.S. sanctions.\textsuperscript{84}

Unilever’s operations in Cuba have not been without problems. As in other JVs, Cuban labor regulations made it difficult for management to motivate the 400-strong workforce, and the government’s recent decision to cut lunch allowances in JVs did little to bolster morale. Labor productivity in the Cuban JV reportedly was below levels registered elsewhere in Latin America and the Caribbean. As a state entity, Suchel may have been more interested in maximizing employment (subject to certain constraints) than in labor productivity. Incidents of pilferage—which are common throughout the resource-scarce Cuban economy—may be especially common in firms dealing with consumer products. In Unilever’s experience, the pilferage levels encountered in Cuba, of some 5 to 6 percent, measured about twice the global average. The unfortunate consequence of very low wages, severe shortages of consumer goods, and a deepening national culture of cutting corners and petty theft, pilferage is a cost of doing business in Cuba.\textsuperscript{85} Furthermore, the labor system that regulates JVs makes it very difficult to fire workers. Cuban labor unions have tended to protect delinquent employees, arguing for remediation rather than retribution.

\textsuperscript{84} As recognized by a Unilever executive, in Cerviño and Bonache, op.cit.
\textsuperscript{85} In their study of the hotel industry, Cerviño and Cubillo found that “employee theft is rampant due to workers’ subsistence wages. Thefts typically involve all the employees in a department; to make sure no one rats out the culprits, all employees share in the proceeds, even managers and those on vacation.” Op.cit, p. 20.
While enjoying a comfortable market share in the hard-currency CUC market, Unilever had largely been excluded from the national currency markets, which are the preserve of state-owned enterprises. Unilever believed it was more efficient than its SOE competitors, not only because of superior management and operations, but also because the firm’s ready access to international credit gave it greater security of supply. Severe shortages of inputs often compel domestic SOEs to interrupt production, disrupting supply to retailers and consumers. Unilever was looking forward to currency unification, when it would be able to compete head-to-head with the SOEs in a single national market.

Suchel, Unilever’s JV partner, benefits from the current, bifurcated market. Suchel runs its own operations in personal and home care products, and has JVs with two Spanish firms: Suchel Cama-cho, which manufactures cosmetics and perfumes, including the popular “Alicia” brand (named for the iconic Cuban ballerina Alicia Alonso), and Suchel Proquimia, which places its bulk cleaning products in hotels. A serious competitive advantage, Suchel enjoys insider information on the technical formulas and corporate strategies of firms operating throughout the industry.

Unilever was also constrained by the government’s intrusion into its supply chain. The government expressed preference for local suppliers, even as Suchel Lever could make the final determination; the JV would oblige the government preference, but only if the local suppliers meet Unilever’s global standards. To its dismay, Unilever’s offers of technical assistance to suppliers were often rejected, apparently because the government did not want to grant access to manufacturing facilities. Of course, government ministries fixed prices for inputs as well as outputs and had to approve spending and investment targets, all negotiated in the annual planning process.

When it came time to renegotiate the Unilever Suchel JV, the Cuban government questioned why Unilever had invested little in recent years. They did not care to recognize that Unilever’s appetite for investment had been dulled by government-imposed disincentives, including the impending contract end-date and the 2008-to-2009 recession-induced payment delays stalling profit repatriation. No longer satisfied with a 50/50 partnership, Cuba pressed new contract conditions and sought a controlling 51 percent; Cuba also wanted the JV to export at least 20 percent of its output. These are terms that Cuba is now seeking to impose on JVs across the board. But Unilever feared that granting Suchel 51 percent would yield too much control and could jeopardize brand quality. Unilever balked at exporting products made in Cuba, where production costs were as much as one-third higher than in Unilever plants in other Latin American countries, notably in Brazil and Mexico where larger volumes allow for more efficient production runs. Unilever did not want to, in effect, cross-subsidize exports from Cuba.
Frustrated at the negotiating process, Unilever professed an inability to discern government motives.\textsuperscript{88} Unilever was unable to penetrate the opaque decision making process or to pinpoint the key decision makers (beyond assuming that President Raúl Castro had the final word). When Unilever CEO Paul Polman—a seasoned CEO accustomed to meeting with ministers and heads of state—visited the island, he was only granted access to a vice minister, and that courtesy only after persistent lobbying by the British embassy.

Was Unilever the victim of a rigid application of Cuba’s more demanding approach to JVs? Or did the state-owned Suchel seize the opportunity to edge out a foreign firm so as to reserve markets for itself? Or did the government’s accumulation of some $25 million in debts tempt it to push out Unilever so it could renegotiate these debts with a subsequent investor on more favorable terms? Or was Raúl Castro’s anti-corruption campaign responsible for freezing decision makers, made fearful of being accused of taking bribes from foreign businessmen?

As of this writing, negotiations continue, at least “for now,” according to Unilever.\textsuperscript{87} Unilever may be playing for time, hoping for a favorable turn in Cuban law or attitudes toward FDI. If negotiations collapse, Unilever was reportedly prepared to sell the machinery to the Cubans, should they wish to purchase and the government so authorize.\textsuperscript{88} Suchel would then have the options of assuming full ownership or of seeking another foreign partner, subject to government consent.\textsuperscript{89} Rumors were circulating in Havana of a possible Brazilian replacement.

Whatever the final outcome of these contentious contract renegotiations, investor perceptions have already been adversely affected. If the Cuban government cannot sustain a good working relationship with Unilever—a highly regarded, marqué multinational corporation with a global footprint—what international investor (at least one operating in the domestic consumer goods markets) could be confident of its ability to sustain a profitable long-term operation in Cuba?

\textsuperscript{88} A possible official motive is suggested in the recent study of FDI by the Center for the Study of the Cuban Economy (CEEC) of the University of Havana. “Cuban authorities find it inconvenient that foreign investors transfer overseas revenues obtained in the domestic market. On the contrary, they expect foreign investors to channel resources into the national economy. Currently, light industry is the sector most oriented toward the domestic market.” CEEC, op.cit., p.7.

\textsuperscript{87} A Unilever company manager was quoted in the media as saying: “We wanted 51 percent of the new venture and so did the Cubans. At this point we are leaving, even though some discussion is still going on.” Marc Frank, “Cuba drags feet on foreign investment,” Reuters, May 15, 2012.

\textsuperscript{88} As provided for in Law 77, Chapter III, “Guarantees for Investors,” Article 6.

\textsuperscript{89} Law 77, Chapter V, Article 13.5 stipulates: “Once the joint venture is created, the partners cannot be changed except with the consent of the parties and the approval of the authority that granted the authorization.” That is, the sale or transfer of investors’ capital to third parties is subject to government approval.
Case Study 7: Alimentos Rio Zaza: The Perils of Political Entrepreneurs

In February 2009, then-president of Chile Michelle Bachelet, President Raúl Castro, and their senior teams were hosted at the palatial Havana home of Chilean businessman Joel Max Marambio Rodriguez. The visiting Chileans were impressed by their host’s lavish lifestyle and by his apparently intimate ties to senior Cuban leadership. Yet, the following year the Cuban Ministry of Justice would accuse Max Marambio of multiple deeds of corruption and seize his properties, most prominent among them the joint venture Alimentos Rio Zaza, S.A., the island’s leading producer of packaged citrus fruit juices and milk.

Figure 3.9. Max Marambio and Fidel Castro

Source: La Fundación Centro de Investigación Periodística (CIPER, www.ciperchile.cl)

Rio Zaza began in 1993 as a 50/50 joint venture involving two Chilean investors, Marambio and Carlos Cardoen (a global arms dealer), with an initial capital estimated at just $2.5 million. The business included upstream citrus plantations. By 2009, Marambio had bought out his partner; by then, Rio Zaza employed about 500 workers with annual sales of around $100 million. Rio Zaza’s Tetra Pak juices were a visible premium brand throughout the island. As democracy returned to Chile, Marambio relocated his primary residence there, but remained a prominent figure among business circles in Cuba.

The story of Marambio and Rio Zaza is the stuff of cinematic drama. As a teenager, Marambio’s father, a militant in the Chilean Socialist Party, introduced him to Fidel Castro, who offered him training in Cuba’s special forces. This unusual education prepared him to take charge of the personal security of Chilean Socialist Salvador Allende upon his assumption to power in the early 1970s. When Allende was subsequently ousted in a military coup, Marambio returned to Cuba where his relationship to Fidel and other prominent personalities opened the door to various bureaucratic and business opportunities. Solidifying his access to the inner circle, Marambio married a daughter of Antonio Núñez Jiménez, a participant in the historic Sierra Maestra guerrilla campaign and Castro confidant.


91 Marambio’s memoir, Las Armas de Ayer (Santiago: La Tercera/Debate, 2007), recounts his early years.
As an entrepreneur, Marambio did not limit himself to fruit juices. He opened a joint venture package tourism agency, Sol y Son, S.A., in close partnership with the Cuban national airlines, Cubana de Aviación. He owned a multinational real estate business that, among other regular guests included staff of the Cuban airlines. Marambio even made a film with Gabriel García Márquez, the famous Colombian novelist and close friend of Fidel’s.

With his many business and political connections, Marambio seemed secure. Moreover, he and his brother Marcel appeared to be excellent entrepreneurs, with good noses for business opportunities and the managerial skills to execute successfully. So it must have come as a shock when government investigators from the secretive Department of Technical Investigation of the Ministry of the Interior began to pick up his associates at Rio Zaza and Sun y Sol. Following lengthy interrogations by government agents, the long-term general manager of Rio Zaza, Chilean national Roberto Baudrand, was found dead in his Havana apartment, the exact cause of death never clarified.

The Marambio brothers have been accused of “Bribery of government officials, acts detrimental to economy activities and contracts, misappropriation of funds, counterfeiting of bank and commercial documents, and fraud.” Not surprisingly, they have chosen to not return to Cuba for trial. In such anti-corruption cases, there is little transparency or legal due process. The accused are not presented with precise charges until shortly before the trial, are interrogated without the presence of legal counsel, and may be held incommunicado for lengthy periods in unknown locations with only sporadic family contacts. Legal experts report that the most the accused can seek to accomplish is to plea for reduced sentences. In May of 2011, the Cuban courts sentenced Marambio to a 20-year prison term in absentia. A number of his alleged Cuban co-conspirators—business associates and senior government officials, including the long-time minister of the foods’ industry—are currently behind bars.

Rio Zaza was not officially expropriated, rather the firm was “intervened” by the government. Initially, it ceased operations and the familiar Tetra-Pak fruit juices disappeared from grocery shelves. It is now operational under the aegis of the Cuban joint venture partner, Corporación Alimentaria, S.A., or Coralsa; Coralsa itself is a dependency of the Ministry of the Food Industry (Ministerio de la Industria Alimenticia, MINAL). Marambio remains a fugitive from Cuban justice.

As is typical with corruption scandals, very little has appeared in the Cuban media about the Marambio case, fueling speculation on the government’s motives. Here are four theories, not mutually exclusive:

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**Individual indiscretion:** Perhaps Marambio’s flamboyant lifestyle was an embarrassment to the Communist elite that live relatively austerely and discreetly. Marambio could irritate government officials; during the 2009 foreign exchange crisis, when the Cuban central bank froze accounts and Rio Zaza could not meet payments to international suppliers, Marambio reportedly expressed his displeasure directly and loudly to central bank officials. Nor did Marambio hide the fact that he paid his workers bonuses, above the officially-set salary levels, during a time when such payments (although commonplace in JVs) were not legal. Further, Marambio may have annoyed some Cubans when, during the 2008 Chilean presidential elections, he provided financial support to a third-party candidate that drew support away from the leftist ticket, leading to the victory of a conservative. In fact, Marambio’s Chilean wife shared interests in the Chilean national airlines, LAN, with its principal shareholder—the rightist candidate, Sebastián Piñera. This gave rise to accusations that Marambio plotted with Piñera to divide the leftist vote. In fact, Marambio had other compelling reasons for his actions.

**Intra-elite power shifts:** As power shifted from Fidel to Raúl, Marambio lost his original patron. Some speculate that the institutional military, with which Raúl is intimately associated, never trusted Marambio because of his experience in Fidel’s personal special forces. Throughout the government, Raúl has gradually replaced many of Fidel’s loyalists with his own, and anti-corruption charges can be part of that game. Perhaps real assets play a role: Raúl’s team will now gain direct control over the lucrative Alimentos Rio Zaza, S.A.

**Pre-liberalization purification:** This official explanation has two variants. The first is that the Soviet Union collapsed because of rampant corruption, so the Cuban revolution must take preemptive measures and varnish its moral legitimacy and principled concern for social justice. Alternatively, economic liberalization, however gradual, runs the risk of opening the gates to a post-Soviet-style corruption, so high ethical standards must be established beforehand. In either of these two explanations, however, the government’s tactics seem ill-chosen. Absent information, citizens tend to see criminal accusations as arbitrary, since “cutting corners” has become commonplace in resource-scarce Cuba. Moreover, the prosecutorial campaign leaves untouched the obvious root causes of corruption: extremely low wages even among senior officials and lack of transparency in both economic and political spheres.
Social Discipline: The more cynical explanation is that communist regimes periodically undertake anti-corruption campaigns. Such campaigns may seek to restore moral purpose, especially at a time of growing economic inequality (as in China today); be an instrument in intra-party factional and personal disputes; or, in the words of a Havana diplomat, serve “to remind citizens who is in charge.” Such anti-corruption campaigns can take on logic of their own, as zealous prosecutors become emboldened—the “revolution devours its sons” syndrome. But the current anti-corruption campaign has also trapped within its widening net a number of foreign businessmen, including not only Chileans but also Canadians and Europeans operating high-profile businesses—from the distributing of premium Cohiba cigars in Europe (employees of the Habanos JV) to remodeling a five-star hotel in downtown Havana (the Saratoga).

The ill-understood anti-corruption campaign, combined with the absence of standard legal protections, has sent a chill throughout the joint venture community and deterred some otherwise interested investors. Rather than foretell a better business climate with higher ethical standards, the campaign has introduced an element of uncertainty and even fear. As has so often been the case in revolutionary Cuba, government officials seem to have given priority to political goals over economic incentives.

Epilogue
Marambio exercised his rights to seek redress before the Paris-based International Chamber of Commerce's International Court of Arbitration, based upon the Cuba-Chile Bilateral Investment Treaty of 1996 and pursuant to both the Cuban FDI Law of 1995 and the Rio Zaza Joint Venture agreement. The three-member panel awarded Marambio $143 million for future loss of earnings and another $10 million for "moral pain and suffering." But the court also recognized that Cuba may pursue their case against Marambio for illicit business activities. It seems unlikely that Marambio will receive financial compensation.

Findings from the Case Studies

The seven case studies make clear that there are significant advantages, and significant drawbacks, to operating within the Cuban socialist system. Firms are pleased at some of the recent economic reforms, but there are also some worrying, contradictory signs of reversion to centralized controls. There is no doubt that FDI is making valuable contributions to their JVs and to the Cuban economy and that foreign firms would be willing to invest more in Cuba if markets—domestic or international—were to expand. U.S. economic sanctions are seen as a cost of doing business, while the lifting of sanctions and access to U.S. markets for Cuban products would be a game-changer.

Advantages of Operating within the Cuban System

Capitalist corporations, one might imagine, constantly clash with socialist planning. In reality, JVs operating in Cuba discover that socialism, while not exactly a capitalist’s paradise, offers a number of distinct advantages:

- Once admitted, JVs are often granted monopolies, or dominant market shares, in key market segments. The Cuban state restricts market entry by other foreign competitors or by national enterprises.

- Profit margins are, in effect, guaranteed by the state. A function of input and output prices set by government planners, profit margins are the outcome of a political bargaining process where JVs discuss with government planners the key business variables: prices and quantities.

- The Cuban economic environment is relatively stable (some might say stagnant). The government sets prices, the labor market is tightly regulated, and competition and innovation are low. In recent years global economic turbulence has impacted the Cuban economy by dampening growth rates and consumer purchasing power, even as there has been a modest recovery.

- The Cuban JV partner serves as an avenue of influence in bargaining with state entities. Generally, the state, holding shares in the joint venture, wants the JV to succeed.
• The Confederation of Cuban Workers and Communist Party cells are embedded within firms. These politicized organizations impinge upon management autonomy and may represent workers' interests, for example, by arguing that social solidarity militates against lay-offs. But these organizations generally align with the production goals of the firm and its associated state agencies. Management need not worry about militant strikes or work-stoppages.

Disadvantages of Operating within the Cuban System

All seven case studies claim successful, profitable operations. Yet all find it challenging to operate in the Cuban context. The top complaint by far is the labor contract system. Other common complaints include price controls that cap profit margins, state interference with the supply chain, and tensions with their Cuban partners over business priorities.

• In capitalist societies, there is constant jockeying among firms, governments, and workers’ associations over the rules governing labor markets. For JVs operating in Cuba, there is no debate: the state exercises total control. JV management bristles at its inability to set wages and bonuses to optimize productivity and labor discipline. Of even greater concern is the exorbitant tax on labor extracted through the dual currency system, which attacks profitability and seriously impairs international competitiveness. For some JVs, the high labor tax is patently inconsistent with the Cuban insistence on export performance requirements.

• Government price controls offer stability and predictability but also constrain profitability. To dampen inflation, Cuban authorities press JVs to improve their profit margins through higher productivity and lower costs rather than through price increases. In response, some JVs complain that their profit margins are too thin to allow for much productivity-enhancing investment or fret that the government will not allow them to expand sales at a sufficiently rapid rate to justify more investments.

• Another disincentive to investment is the time limitation on JV contracts. Facing a deadline that could result in the revocation of their license to operate, firms are prone to invest less and less as the contract end-date approaches.

• A multinational is only as good as the weakest link in its supply chain. Some seasoned multinationals, such as Nestlé, have always focused on the quality of their inputs, while others are becoming more conscious of the need to intervene further and further upstream to ensure quality control as well as compliance with social (labor, environmental, and health) standards. But in Cuba, some JVs noted, the state inserts itself between the JV and its suppliers. This creates risks for the JV and also deprives suppliers of the operational know-how that multinationals routinely diffuse throughout their supply chains elsewhere in the world.

• The Cuban JV partner may house contradictory loyalties. It has a stake in the success of the JV, but is also a dependency of the Cuban state. Some foreign investors reported being accustomed to placing more emphasis on consumer welfare and other marketing considerations,
while their Cuban partners focus more on meeting planning targets set by the state.\textsuperscript{94} Where the Cuban SOE also owns competing firms, it may face conflicting loyalties.

- Notwithstanding the generally stable political context, JVs feel vulnerable to sudden changes in the rules of the game. The state can alter the environment, for example, with regard to prices of vital inputs such as energy and land, also known as rents. Tolerance for “gray area” practices can change, as the anti-corruption campaign has retroactively accused unlucky executives of illicit practices. In extreme cases, government entities, ministries, or competing SOEs may decide to pressure a JV to sell or abandon its assets, to the benefit of better connected Cuban interests. “One day you’re welcome, the next day you’re in jail,” observed an executive with a large multinational waiting for more stable rules of the game before venturing into Cuban markets.

**Signs of Economic Reforms**

JVs would like to see major reforms in the labor laws and the dual currency system. Already they report some positive changes in these spheres as well as in others:

- Some workers are now permitted to hold two jobs and some employers can hire part-timers, adding welcome flexibility to labor markets.
- The government is also permitting some firms to reduce staff, giving greater weight to labor productivity over employment security.
- On an experimental basis, some tourist establishments have been authorized to purchase directly from local suppliers, without the intermediation of cumbersome state distributors and at prices that imply a more realistic rate of exchange.

**...But Some Backward Steps**

- The 2011 reform guidelines suggest enduring distrust toward FDI within important segments of the Cuban state and society.
- New rules that diminish the flexibility of JVs in granting small perks, such as better lunches, to employees manifest a deep ideological preference for equality over productivity.
- Disappointing delays in project approval and in the much-anticipated reforms of the foreign investment law override persistent rumors of imminent action. Deferrals suggest divisions within the state and, quite possibly, opposition in high places.
- The threatened ouster of Unilever has been a rude shock to the JV community, but it followed a pattern of removing foreign firms from the Cuban landscape. Notably, in early 2011 the state telecommunications firm, ETECSA, bought out its Italian partner, Telecom Italia, and deflected expressions of interest by Spain’s Telefónica in order to retain monopoly

\textsuperscript{94} A recent questionnaire survey of Cuban business executives, some working for JVs, confirmed that JVs focus more attention on marketing. Julio Cerviño, Joan Llonch, and Josep Rialp, “Market Orientation and Business Performance in Cuban Firms: A Comparative Analysis of State-Owned Versus Joint Venture Cuban Firms,” (presented at the Association for the Study of the Cuban Economy (ASCE) annual meetings, 2012, Miami).
control of what must be a highly-profitable and politically-sensitive sector. The takeover of Rio Zaza, the fruit juice firm, paralleled the more quiet disappearance of the Israeli firm, BM, also a manufacturer and distributor of citrus juices.

- Raúl Castro’s July 2012 trip to China and Vietnam, despite the apparent absence of major new accords, highlighted the growing preference for state-to-state deals over JVs with private investors.

**FDI Brings In Its Wake Important Contributions to the Cuban Economy**

- As routinely occurs every day around the world, FDI flows have arrived in Cuba bundled with world-class management expertise, new technologies, international product and process standards, and sustained product innovation.

- Joint venture managers believe that their business models are more efficient than competitor Cuban SOEs. Joint venture expats, who are few in number in each firm, work hard to impart their management know-how to their Cuban colleagues.

- Sol Meliá trains thousands of Cubans in hotel management and customer service. Some JVs, such as Brascuba, cycle Cuban staff through their standardized training programs in home countries. Former senior executive of CIMEX, Emilio Morales, asserted the contributions of JVs “cannot be underestimated; they have been responsible for training personnel in accounting, finance, management, human resources, information technology, marketing and related fields. Some employees have been trained in Cuba and many have studied abroad...”

- Firms like Habanos continually innovate new products (such as premium cigars) for global markets, while Nestlé draws on its global R&D to launch new products on Cuban markets.

- Most importantly, JVs such as Habanos and Pernod Ricard (Habana Club rum) facilitate access to global markets for premier Cuban products. Equally vital, multinationals draw on their global credit ratings to access international lines of credit at standard interest rates, well below what Cuban borrowers would have to pay on their own.

**The United States Looms Large, as an Adverse Factor Today, as a Big Opportunity Tomorrow**

- The JVs active in Cuba today believe their legal staffs are keeping them safe from potential U.S. sanctions. But U.S. sanctions, by depriving firms of certain U.S. technologies and other inputs, raise the costs of doing business in Cuba by as much as 20 percent in some cases.

- The seven JV case studies all reported profitability; that is, none are operating at a loss anticipating better days. But many are lying in wait for the opening of the U.S. market: tantalizingly nearby, immense in purchasing power, and prepared to pay premium prices

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95 Morales and Scarpaci, op.cit., chapter 6. Before emigrating to the United States in 2006, Morales served as Director of Strategic Marketing in the Planning Department of CIMEX.
for exotic Cuban brands. Some JVs already have plans to dramatically expand their investments when that banner day finally arrives.

Further Evidence: European Investor Opinion

The findings from these case studies were bolstered by evidence gathered recently by the prestigious Center for the Study of the Cuban Economy (CEEC) of the University of Havana, whose economists surveyed the commercial attachés of members of the European Union in Havana regarding the perceptions of actual and potential investors from their home countries. The survey, with both quantitative and open-ended questions, was limited to 15 diplomats and did not directly access JV managers, but the main findings are telling.

Figure 3.12. The Cuban Business Climate: Positive Indicators

Figure 3.12 showcases the attractive qualities attributed to the Cuban business climate, as recorded by the CEEC survey. While helping to explain some FDI decisions, these positive qualities require careful qualification:

- As of late, personal security has been jeopardized by the government’s anti-corruption campaign that has jailed some foreign investors.
- Respondents qualified their praise for the Cuban workforce with expressions of concern about labor discipline and motivation. Just about any Cuban—whether manager or worker—will readily complain about low wages and weak incentives, while responsible government officials, including President Raul Castro, routinely excoriate citizens for their poor work ethic.
- The most exciting business expansion that many JVs have in mind is an opening to the U.S. market, whose timeframe remains a big question mark.
- And while the Cuban Communist Party has provided remarkable political stability, the advanced age of the current leadership and uncertainty regarding succession planning raise major questions about the evolution of Cuban politics over the long term.

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The survey of EU diplomats found these indicators where the Cuban business climate was considered negative (explanatory comments are to the right):

**Figure 3.13. Cuban Business Climate: Negative Indicators**

<table>
<thead>
<tr>
<th>Procedures for authorizing new businesses</th>
<th>• Very slow and non-transparent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor contract regime</td>
<td>• Lack of direct management control, relatively high cost</td>
</tr>
<tr>
<td>Financial system</td>
<td>• Blocked accounts and payment arrears</td>
</tr>
<tr>
<td>Legal regime</td>
<td>• Too slow and uncertain resolution of conflicts</td>
</tr>
<tr>
<td>Property rights protection</td>
<td>• Limited time duration of JV contracts</td>
</tr>
<tr>
<td>The state as a partner</td>
<td>• Unequal power balance</td>
</tr>
</tbody>
</table>


Without exception, these are vital issues in defining an investment climate: the availability of labor and capital, the quality of the legal system, and the protection of property rights. That these issues fall, for the most part, in the negative column explains why the supply of FDI to Cuba has fallen far short of its potential magnitude.
4. The Diaspora as Investors

The overseas Chinese and Vietnamese are two examples of diasporas that have made use of their kinship connections and cultural knowledge to help fund economic development in their home countries. Many of the 1.8 million Cuban-Americans (2010 U.S. Census) have prospered and would invest in Cuba—if the two governments allowed them to do so under reasonable conditions.

According to Miami real estate lawyer Antonio Zamora, a Bay of Pigs veteran who has since traveled to Cuba dozens of times, there could be a booming condominium market for mainland investors and Cuban-Americans looking to retire in a culturally-comfortable environment that offers good health care and relatively inexpensive, secure living. Zamora also counts some 20 golf resort and boat marina projects on the drawing boards—of which four alone are worth more than $1 billion—waiting for the green light from Cuban authorities.97

The future of investments by Cuban-Americans is linked to Cuba’s immigration rules, which currently deprive many émigrés of the right to own property. Changes in the rules governing émigré property holdings could set the stage for the release of pent-up Cuban-American demand for housing, property, and other investments on the island.

Already many Cuban-Americans are pumping money into their relatives’ restaurants and other small businesses now authorized as part of the regime’s policies of growing the non-state sector (private businesses, cooperatives, and private farms). U.S. sanctions do not yet permit investments—risk capital seeking a return—on the island, but do permit donations. The conditions under which these remittances occur are known only to the parties to the transfer. They may lack formal

97 Statement at the annual meetings of the Association for the Study of the Cuban Economy (ASCE), Miami, Florida, August, 2012; and cubastandard.com, February 2011. However, some of the proposed golf resorts pertain to non-U.S. investors.
legal protection, but as some Cuban-Americans assert, “trust can be a stronger bond than written
contracts.” One informed Cuban-American businessman estimated that as many as 80 percent of
the larger paladares (restaurants) opening in Havana benefit from expatriate funding. Thus, the im-
position by the Cuban government in September 2012 of hefty taxes on gift parcels, some carrying
materials for use by small businesses, was a setback to emerging private enterprises (Figure 4.1).98

Very few Cubans can accumulate savings from their meager salaries, as obligatory social celebrations
and pagan religious ceremonies quickly consume petty cash. Cuban state banks are accustomed to
lending to medium- and large-scale enterprises, not to risky start-ups. Hence, aspiring Cuban entre-
preneurs must rely on remittances or, in some cases, income earned during sojourns overseas. The
financial constraint is a major obstacle to the blossoming of the small-scale private sector.

The Miami-based Cuba Study Group has partnered with the Catholic Church-affiliated Félix Varela
Center to offer instruction to aspiring micro-entrepreneurs in subjects such as accounting, market-
ing, and composing business plans. The project, “Cuba Emprende,” will also provide low-interest
long-term loans as well as mentoring to new firms. If successful, Cuba Emprende could be a proto-
type of cooperation between businesspersons in the diaspora and the emerging private sector on
the island.

Despite the numerous obstacles, many Cubans are now dreaming of starting their own businesses—
and some are succeeding. For example, they are succeeding as owners of fine-dining restaurants,
stands selling cream-filled churros, a beauty salon specializing in Afro-Cuban hair styles, a high-
concept barber shop, a graphics design venture, a cellphone repair shop, home remodeling, and as
managers of apartment rentals and taxicab fleets.99 Many of these young businesses are receiving
some form of assistance—remittances, supplies, or customers—from the diaspora.

The United States could do much more to bolster Cuba’s emerging entrepreneurs. It could facilitate
the pooling of remittances targeted at investing in non-state firms. More boldly, the United States
could lift sanctions on investment and trade with non-state Cuban firms rigorously certified as
genuine private businesses and independent cooperatives.

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98 One knowledgeable observer estimated the value of remittances entering Cuba at $2.2 billion and of merchandise
entering as packages at $2.0 - 2.5 billion in 2011. Emilio Morales, "What’s behind the new Cuban tariffs,” The Havana

99 Richard E. Feinberg and Collin Laverty, Cuba’s New Entrepreneurs: Recent Experiences and Policy Options, forthcoming,
2013.
Larger investments by Cuban-Americans, or by U.S.-based corporations, must await changes in regulations in both nations. The outstanding claims of properties expropriated in the early years of the revolution stand as another barrier to investment flows.\textsuperscript{100} As emphasized throughout this study, changes in legal frameworks by themselves will not be sufficient to unlock large-scale investment flows. Many U.S. individuals and firms will wait until they perceive a more attractive investment climate, with all that entails. Some Cuban-Americans may exhibit a somewhat lower threshold, whether as the result of a “sentimental premium” or because they believe that their strong social networks reduce their risks.

\textsuperscript{100} For an expert discussion of settlement options, see Rolando Anillo-Badia, \textit{Outstanding Claims to Expropriated Property in Cuba}, (Proceedings of the Association for the Study of the Cuban Economy (ASCE), Miami, 2011).
5. Costa Rica’s Warm Climate for FDI: Lessons for Cuba

No two countries are exactly alike, but the similarities between Costa Rica and Cuba are striking. Both are small countries located in the Caribbean Basin. Costa Rica’s population is 4.6 million, while Cuba’s is 11.2 million. Both have long relied on agricultural exports and tourism to generate foreign exchange. Both have given high priority to delivering quality social services to their populations and take pride in their universal public health-care systems and high-performance schools and universities. These factors have caused the two nations to obtain similar rankings on the United Nations’ human development index. Moreover, both have strong governments. In Costa Rica, the state controls the majority of the banking system, has set aside one-quarter of the national territory for conservation, maintains tough environmental standards, and commands an extensive maze of regulations—such that the private sector bitterly complains about excessive governmental intervention and red tape.101

Of course there is one striking difference: Costa Rica is a stable, pluralistic democracy, with tremendous pride in its civic culture and electoral system. Just about every well-educated Costa Rican imagines that he or she can one day become president—or at least take a shot at being a candidate in one of the open party primaries. The presidential inaugurations are wonderful festivals in affirmation of the national identity of egalitarian democracy. And one more thing: Costa Rica abolished its army in 1948—for real! This remarkable feat occurred after a brief civil war in which the victorious party, rather than revel in its military victory, chose instead to bury its armaments. In effect, Costa Rican diplomacy has relied on the security umbrella of the United States, 180 degrees contrary to the path chosen by the Cuban revolution that occurred only a decade later.

101 The World Economic Forum’s “Global Competitiveness Index” (2011) lists “inefficient government bureaucracy” as the most problematic factor for doing business in Costa Rica.
In the realm of economic policy, Costa Rica and Cuba also made different choices in the face of severe external shocks. In responding to the external debt crisis of the 1980s, Costa Rica abandoned its earlier policy of protecting local industry (“import substitution industrialization”) and opted to integrate into the global economy and make the attraction of foreign investment a centerpiece of national development policy. In contrast, in response to the collapse of the Soviet Union and after a brief flirtation with liberalization, Cuba chose to dig in and maintain a command economy.102

As a result, over the last two decades the Costa Rican economy has grown at a steady 4 to 5 percent annual clip: per capita GDP now reaches $10,500; nearly twice Cuba’s $5,400.103 In fact, the differences are probably greater, as will become apparent once Cuba’s badly distorted relative prices, including its exchange rates, are fully adjusted. One telling indicator of Costa Rica’s success: despite the ease of emigration, Costa Rican youth choose to remain at home. The number of Costa Ricans living in the United States is only 126,000 according to the 2010 U.S. Census, as compared to 1.8 million Cuban-Americans. Costa Rica does not suffer from brain drain of its best and brightest, a major concern to Cuban policymakers as they implement a major relaxation of travel restrictions in 2013.

The Multiple Impacts of FDI

The influx of FDI into Costa Rica has risen steadily, from 2 percent of GDP in the late 1980s to 3 percent in the period from 1995 to 2004, to over 5 percent of GDP since 2004 (Graph 5.1). Costa Ricans have been able to attain rising consumption levels and reduce poverty to under 20 percent and extreme poverty to 3 percent of the population. Costa Rica achieves this while maintaining respectable rates of investment by supplementing national savings with substantial inflows of foreign savings. Exports have risen in tandem, soaring from $2.2 billion in 1990 to $13.6 billion in 2010. The Ministry of Foreign Trade (COMEX) calculates $2,275 in exports per Costa Rican spread among 2,414 firms (each selling at least $12,000) and 4,315 products as of 2011.

But just as impressive as the aggregate accomplishment is the change in the composition of investments and exports. High value-added manufacturing and service exports now dominate traditional agricultural products—a direct result of foreign investments in those new sectors. Costa Rica does not compile numbers on the total employment of FDI firms, as it does not require firms to register the source of their capital.104 For the three years from 2009 to 2011, the OECD estimated that new

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102 For an early treatment, see Carmela Mesa-Lago, Market, Socialist, and Mixed Economies: Comparative Policy and Performance: Chile, Cuba, and Costa Rica (Baltimore: Johns Hopkins University Press, 2000).
103 Figures are on a purchasing power parity basis, as estimated in the United Nations Development Program, Human Development Report (New York: UNDP, 2011), Table 1, pp. 127-130.
104 Foreign investors are granted “national treatment,” and face no special approval or registration requirements, but if they wish to obtain the “foreign trade zone” exemptions from tariffs and taxes they must meet government- set criteria. Nationally-owned firms are also eligible for foreign trade zone treatment.
FDI projects created 34,000 jobs; however, this calculation does not capture the many additional jobs generated in direct contracting and domestic procurement.\textsuperscript{105}

There are over 200 foreign investments in Costa Rica’s many FTZs. To qualify, investments must export goods and services and fall within government-designed priority sectors (there are many other foreign investments and franchises outside the FTZs, in agriculture and agro-industry, tourism, real estate, retail trade, and finance). Among the leading FTZ investors in the life sciences cluster producing medical devices are Abbott Vascular, Allergan, Arthrocare, Baxter Healthcare, BeamOne, Boston Scientific, Covidien, Hologic, Hospira, and St. Jude Medical. Leading firms in the advanced manufacturing sector include Bridgestone, Firestone, Panasonic, Vitec, Eaton, Phelps Dodge, Teradyne, and Emerson Leading. Firms in semi-conductors and telecommunications sectors include Intel, L3 Communications, and Panduit. The software and digital media clusters have attracted Avionyz, Fiserv, Intertec,\textsuperscript{106} Softtek, and avVenta. The services sector subdivides into contact centers (ACE, Aegis Communications, Amazon, Dell, Fujitsu, Hewlett-Packard, Sykes, and UPS) as well as back office (Amba Research, Equifax, Experian, IBM, L.L. Bean, and Pacific West)


and shared services (Amway, Astra Zeneca, APL, British American Tobacco, Chiquita Brands, Citi Business Services, DHL, Dell, Intel, National Instruments, Oracle, Procter & Gamble, and Western Union), among other investors. More firms are entering yearly.

Taking advantage of its varied climates and lush rain forests, Costa Rica is world-famous for its eco-tourism. In 2010, relatively small Costa Rica attracted 2.2 million tourists—nearly as many as Cuba’s 2.5 million. In an impressive exercise in transparency and accountability, Costa Rica’s tourism board issues a “Certificate of Sustainable Tourism” to hotels and resorts, with ratings from one to five based on a detailed survey posted on its website. The goal is to stimulate best practices in environmental protection and community relations by offering good publicity to high performers. Building on its certified medical centers and price-competitive medical professionals, Costa Rica is now promoting medical tourism. At the same time, Costa Rica wants to maintain a moderate, sustainable growth rate in its tourism sector, which it controls by carefully limiting the number of arriving airplane flights.107

In Costa Rica, FDI has been a strategic goal of public policy and a principal driver of economic development. FDI not only made a big difference in investment rates and the growth and composition of exports, and generated many good jobs (directly and indirectly), but also had a powerful impact throughout the economy. In some cases, the diffusion has been measurable, as when former employees of multinationals migrate to national firms, embodying within themselves technology transfer, managerial know-how, and social networks.108 Many multinationals—such as Walmart and PriceSmart in retail shopping; Dole, Chiquita, and Starbucks in agricultural commodities; and Boston Scientific and Hospira in medical devices—source from local producers, requiring them to meet international standards of product quality, low-defect reliability, and on-time delivery. The demonstration effect diffuses throughout the economy; government agencies, business associations, university centers, and think tanks apply international benchmarks to stimulate national producers to raise their game.

Finally, China is another promising source of foreign investment. Only in 2007 did Costa Rica establish diplomatic relations with Beijing, such that through 2011 Chinese investment in Costa Rica totaled only $11.5 million. Now, according to official Costa Rican sources, the Chinese National Petroleum Company expects to invest $1 billion in a joint venture with the state oil firm, RECOPE, to

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107 Author interview with official at the Institute for Costa Rican Tourism (ICT), San José, July, 2012.
build a new refinery. The China Development Bank is undertaking a feasibility study to construct a FTZ to serve as a hub where Chinese firms could manufacture and distribute products throughout the Americas.

**Why Costa Rica?**

Why have foreign investors chosen Costa Rica over the many other alternative locations? The 1996 decision by Intel to locate one of its ultra-high tech semi-conductor assembly and testing plants has received extensive academic attention. Intel was impressed by Costa Rica’s democratic stability, its strong public-sector institutions, its policy continuity, and the personal attention of the then-president, Jose Maria “Pepe” Figueres. The investment promotion agency, CINDE, received high marks for its technical intelligence, quick responsiveness, and ability to serve as a bridge between FDI and government agencies. Intel was pleased at the quality of the Costa Rica workforce, but projected a growing demand for mid-level technicians; CINDE engaged the national Costa Rica Technological Institute and the network of vocational training institutes to meet that demand. Intel speaks of the importance of a “robust, open econ-system,” where government, business, and academe interact to keep pace with and drive technological change.

Less frequently commented on is the contribution of a cohesive group of “transnational technopols,” well-traveled Costa Ricans educated in the social sciences who rotate within senior cabinet positions and the central bank. These experts provide policy continuity while updating policies in response to changing global realities. The current minister of trade and former executive director of CINDE, Anabel González, who has also worked at the Inter-American Development Bank in Washington, D.C. and the World Trade Organization in Geneva, is an outstanding representative of this elite network.

When commenting on the Costa Rican workforce, employers refer not only to their education and good English but also to their positive work ethic—their enthusiasm, responsiveness, and thirst to learn. Costa Rica is not trying to compete against low-wage Asian labor, but wages must be internationally competitive. Engineers earn from $2,300 to $3,200 per month including benefits; factory-floor operators earn from $600 to $1,200 a month. Wages are rising, however, driving Costa

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Rica to stimulate educational institutions—both vocational training schools and universities—to collaborate more closely with labor markets to increase the supply of graduates in demand and concentrate on further raising labor productivity and climbing higher on the value-added chain in the international divisions of labor. The Inter-American Development Bank and World Bank will be investing heavily in this upgrading of national education.

A Comprehensive Competitiveness Strategy

Costa Ricans are not just basking in their accomplishments; on the contrary, they are highly self-critical and are aware of the awesome challenges that lie ahead of all developing countries.\textsuperscript{113} The dynamism of the global economy demands nimble responsiveness and continual improvement. Costa Rica is striving to improve its physical infrastructure, especially its network of roads, seaports, and airports, and to lower the costs of telecommunications and energy. Long-term planning and investment in renewables has already enabled Costa Rica to reduce its dependency on hydro-carbons to under 10 percent of energy consumption. The World Bank has helped Costa Rica assess its requirements for upgrading its lagging infrastructure.\textsuperscript{114} Regulatory regimes are under close scrutiny to make them smarter and more responsive to changing technologies. Government programs are striving to encourage more backward linkages between FDI and domestic firms.\textsuperscript{115}

More broadly, two separate efforts are underway to improve national competitiveness: an interagency public-sector council chaired by President Laura Chinchilla and a new private-sector association. Backed by major foreign investors, this association hopes to inject a long-term perspective into the public consciousness. Two challenging next-generation issues are identified in the competitiveness agenda: creating a deeper domestic capital market that would provide venture capital to promising start-ups and building a national innovation strategy with an indigenous research and development capacity.

In the social and political realms, Costa Rica is facing additional dilemmas. The further skewing of income distribution—widened by the immigration of unskilled Nicaraguan labor—is tearing at the social fabric and violent crime has risen albeit from subdued levels. Although low by regional standards, poverty remains an important concern, as public policy seeks to encourage investments into more remote, poorer regions. The political system is becoming more fragmented and harder

\textsuperscript{113} For example, Ennio Rodriguez, “Nuestras oportunidades perdidas,” (Our lost opportunities), La Nación, July 22, 2012, p.29A.
to manage and Costa Ricans are hotly debating the optimal size of government. Many economists believe that tax revenues need to increase by some 2 to 3 percent of GDP in order to fund necessary upgrades in social services and infrastructure. These are worldwide conundrums. Nevertheless, when queried in international surveys, Costa Ricans qualify themselves among the happiest peoples on earth!

Lessons for Cuba

While not professing that Cuba should blindly mimic Costa Rica, or any other country, the Central American nation’s successes and shortcomings suggest a number of pertinent lessons for Cuba:

- To compete for FDI in the global economy, countries can profitably build on their comparative advantages: their educated workforce, attractive eco-systems, and low-crime environment, as well as their geographic location near major markets.
- A small latecomer to globalization needs a coherent national strategy, clearly articulated by senior leadership and faithfully implemented by a nimble, responsive bureaucracy.
- An effective FDI strategy is much more than a set of laws and special incentives. It requires establishing an attractive business climate, touching on a myriad of attributes ranging from education to labor market conditions, physical infrastructure, and public policy predictability.
- Creating an attractive business climate does not necessarily imply a simplistic “neo-liberal” shrinking of the state; on the contrary, the public sector has critical roles to play, among them ensuring basic services and designing and executing an investment promotion strategy. Positive collaborations among government, academia, and business are necessary to equilibrate labor demand and supply, and most ambitiously to build a national research and development capacity.
- Steady FDI inflows can help to relax the savings-consumption trade-off, grow and diversify exports, create skilled jobs, and reduce poverty.
- With careful planning and management, niche tourism—for example, in eco-tourism and medical tourism—can contribute to national development goals. Cuba has abundant resources in both areas.
- The international financial institutions can assist through advice on global market conditions, international benchmarking, and financial resources—for example, for large infrastructure projects and educational upgrading.
- Policymakers need good data to design and analyze policies and to demonstrate to taxpayers that their monies are being spent efficiently. A cadre of polished transnational technopols is a valuable national asset.
6. Policy Recommendations

It is time for Cuba to extract its rightful share of benefits from participating actively in the global economy. But the Cuban economy has a long way to go before most foreign investors would be willing to take significant risks on the island.

Most importantly, Cuba needs to overcome its animosities and fears and reach a national consensus that, as a small island economy, its economic future depends upon a healthy engagement with the international economy. As many other proud nations have discovered, it is possible to accept FDI without sacrificing national sovereignty and governance capacity. On the contrary, FDI can provide resources—including investment capital and fiscal revenues—that enhance national choices.

If Cuba had allowed FDI inflows equal to 5 percent of its GDP during the last decade, or roughly $2.5 billion a year, Cuba would have supplemented its domestic savings by some $25 billion. This would have enhanced its ability to recapitalize its productive base while preserving and upgrading the quality of its social services. The Cuban government should send clear signals—including to its own bureaucrats—that it has moved beyond ambiguity and distrust toward a reasoned appreciation of the benefits that foreign investment can bring to a small island economy.

To begin to gradually improve the investment climate, Cuba could:

- Complement the 2011 reform guidelines with a coherent national competitiveness strategy that announces a prominent role for foreign investment. In designing this forward-looking strategy, the government should consult with existing joint venture executives.

- Completely overhaul the investment approval process, making it more transparent and much faster, as promised in the 2011 guidelines. To facilitate rational decision making by both parties, representatives of proposed investments should have ready access to responsible government officials. So that potential investors can better design projects to meet Cuban national priorities, official rulings should be accompanied by robust explanations. Smaller investments should be placed on a fast-track authorization process.
Detail the approval criteria for the new FTZs, with its fiscal incentives, and include a coherent list of priority clusters.

Remove the fixed-time horizon facing investments outside of the FTZs, which promotes myopic behavior and disinvestment as the deadline approaches.

Not exclude multinationals that serve the domestic market simply because they do not readily fit into a national export promotion strategy. Cuban firms cannot replicate the massive R&D and product innovation pipelines that characterize international giants such as Nestlé or Unilever, and whose outputs Cuban consumers will demand.

Build forcefully on the successful strategy of selling quality Cuban products through established international marketing machines. This can be accomplished, for example, by forging alliances among pharmaceutical giants with global reach to make patented Cuban medical innovations available to consumers worldwide.

Encourage FDI to integrate local firms into their supply chains. An inter-ministerial committee should build an integrated strategy to assist local firms to meet acquisition requirements. Include private businesses and cooperatives in an ambitious trade facilitation strategy that targets small and medium enterprises.

Permit foreign investors to form a business association that would allow them to engage in a constructive dialogue with the government. Encourage investors to adapt corporate responsibility practices that observe Cuban laws and national goals and serve corporate stakeholders, including workers, communities, and consumers.

Sharply reduce the implicit tax on labor, to the benefit of Cuban workers and the competitiveness of exports. Eventually dismantle the dual currency labor payment system altogether.

Recast the anti-corruption campaign to focus on root causes: low wages and non-transparency. This can be done, for example, by shining sunlight on the procurement procedures of government entities and SOEs. Combating corruption in both the public and private spheres is critical to sustainable economic development, but properly structured incentives, not arbitrary prosecutions, are the more sustainable pathway toward ethical business practices.

Publish much more data and analysis on the capital account and on FDI, including impacts on savings and investment, employment and wage levels, supply chain integration, and net export earnings. Such publications would help Cuba to gradually converge with international best practices while improving the capacity of Cuban economists to analyze experiences and improve policymaking. Not all of this must await a relaxation of threatening U.S. sanctions.

Cuba could benefit tremendously from learning from other nations that have successfully extracted benefits from foreign investment. The international financial institutions (IFIs) offer a cost-effective short-cut to assess the applicability of comparative country experiences. As argued in Reaching Out: Cuba’s New Economy and the International Response, now is the time for the international development community to engage in Cuba and support its incipient economic reform process.
Under their own new guidelines, the international financial institutions are capable of working within Cuban national priorities while they contribute their unique bundles of knowledge and capital. With regard to FDI, IFIs are particularly well equipped. Furthermore, the presence of the IFIs would add credibility to Cuban investment commitments and to contract enforcement—important ingredients in establishing a more secure investment climate in a changing Cuba. For these reasons, Cuba should signal to the IFIs its interest in entering a gradual path toward receiving, first technical assistance (studies, training) and eventually full membership.

**The IFIs should begin preparations to:**

- Engage with Cuba on a wide-ranging discussion of its national FDI strategy and the many roles that FDI is playing in member states in promoting national economic development. Review international experience with performance requirements (notably, on exports and domestic procurement) and consider alternative fiscal incentives to accomplish national goals.

- Help Cuba design its national competitiveness strategy, drawing on the experiences of similar economies. Assess international markets of special interest to Cuba (such as tourism, nickel, sugar, and biotechnology), to help Cuba understand how it could best fit into global supply chains and leverage and maximize its national advantages—including its human capital, natural resources, and market location.

- Share assessments of the many country experiences with FTZs, so that Cuba can avoid repeating common missteps. Subsidies should be carefully targeted toward industries that will propel Cuba into high value-added production and good wages. At the same time, some investment projects that require less skilled labor could usefully employ the less educated segments of the Cuban workforce.

- Work with Cuban economists to examine the business climate and to design a realistic and sequenced set of corrective measures.

- Provide technical assistance on the many tough economic reform issues confronting Cuba, including the unification of the dual exchange rate system and the substitution of the non-competitive tax levied on JV employees with compensating revenue measures.

Around the world, the United States routinely seeks to promote market-oriented economic reforms by encouraging foreign investment and by lending support to the emerging private sector. A full discussion of U.S. economic sanctions on Cuba is beyond the scope of this study, but even within existing legislation the executive branch possesses wide powers to alter U.S.-Cuban economic relations.116

**The United States can:**

- Avoid politicizing or standing in the way of Cuba’s readmission to the IFIs. The United States should signal to Cuba that while current U.S. legislation requires it to vote against

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Cuban membership in the IFIs, the U.S. would not oppose IFI technical assistance to Cuba. At the same time, the White House should initiate a review of Congressional mandates that condition U.S. policies toward Cuban engagement with the IFIs, with the aim of allowing a more flexible U.S. response to Cuban expressions of interest in working with the IFIs.

- Announce that the President will continue to waive Section III of the Helms-Burton Act, which threatens sanctions against investors “trafficking” in confiscated U.S. properties. Our allies in Europe and in the Western Hemisphere have strongly condemned this measure as illegal under international law, even as private firms fear being caught up in costly legal procedures.

- Build on the recent liberalization regarding remittances and travel to further facilitate assistance to the emerging private sector in Cuba. The U.S. Treasury should clarify regulations with regard to pooling remittances for non-state recipients. Move boldly to lift sanctions on investment and trade with non-state Cuban firms rigorously certified as genuine private businesses and independent cooperatives.

- Begin planning with interested U.S. firms approaches to resolving outstanding expropriation claims, as a prelude to the resumption of U.S. investments on the island.

Looking Ahead

Cubans will decide the roles that foreign investment will play in the island’s development. But it is difficult to imagine that Cuba, with only its own resources, can save enough, innovate rapidly and widely enough, and access enough distant markets to meet the rising expectations of the Cuban population. Rather, Cuba should make up for lost time, learn from its mixed experiences with joint ventures and free trade zones, and study the success stories of other developing countries in harnessing foreign capital for national development. Cuba should also recognize that far from being a threat to the social gains of the revolution, international capital is the best hope for preserving quality social services within the context of a more productive and competitive national economy.

Cuba is richly endowed with more than enough comparative advantages to compete successfully in the global economy. The Cuba of the 21st century can offer deep history (a renovated Habana Vieja), attractive lifestyles (sun and surf, rum, and tobacco), quality performing arts and design, cutting-edge innovations in medicine and healthcare, and enduring affinities to European, Latin American, and U.S. popular cultures. A good portion of the work force is already well educated, including in engineering, mathematics, and computer technologies.

Rather than perceiving its proximity to the United States as a danger, Cuba will sooner or later grasp the tremendous opportunities of a mass market of over 300 million consumers. At the same time, when compared to the pre-revolutionary Cuba of the 1950s, today’s more diversified global economy offers a plethora of competing sources of capital; a new Cuba will host a rainbow of international investors who will be more respectful of Cuban political sovereignty.
About the Author

Richard E. Feinberg is professor of international political economy at the School of International Relations and Pacific Studies, University of California, San Diego. His four decades of engagement with inter-American relations spans government service (in the White House, Department of State, and U.S. Treasury), numerous Washington, D.C.-based public policy institutes, the Peace Corps (Chile), and now in academia. He is also the book reviewer for the Western Hemisphere section of Foreign Affairs magazine. Feinberg is a nonresident senior fellow with the Latin America Initiative at Brookings.