

## A COMMENTARY ON FOREIGN INVESTMENT IN CUBA

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Cuba's foreign investment climate offers unique "enticements" to certain investors. In addition to offering a highly educated workforce and some comparative advantages in a few select industries, some singular characteristics of the investment climate—among others, the absence of labor unions and commonly accepted labor rights, and even the political stability, or perception thereof, offered by a dictatorship firmly in control—may help lure a certain category of investors. Importantly, Cuba seems to offer the potential—how realistic or rapidly is uncertain—to become a new emerging market if and when its political and/or economic system are liberalized. This in and of itself, in addition to the expected appetite of a huge U.S. market, creates a speculative enticement to invest.

Notwithstanding all of the above, the flow of foreign direct investment (FDI) into Cuba in the last decade or so—since its opening after the end of the Soviet era—has been very disappointing both in overall cumulative terms as well as comparatively in global terms. From 1991 to 2000, cumulative FDI reached a mere \$1.5 billion.<sup>2</sup> By the end of 2000, there were 392 "economic associations" in existence,<sup>3</sup> although we are not sure about the exact number of joint ventures involving FDI because Cuba does not disclose

these figures. These are very low numbers for a market that has just opened up and for the extensive marketing efforts of the Cuban government, aided by a willing media. As far as international comparisons go, we will skip them for the sake of time and space, but I can assure you that Cuba's record is one of the lowest in the entire world.

This, of course, is the result of "the market at work"—a mere reflection of the highly risky investment climate Cuba represents. Risk considerations, after all, tend to ultimately override speculative rushes. Vietnam offers a good recent example. As soon as businesses conduct due diligence or, in some cases, actually experience the realities of investing in such a challenging environment, the hype begins to dissipate to a more realistic assessment of true conditions. This almost certainly explains the relatively high turnover rate of investments in Cuba. Of the 540 "economic associations" formed between 1988 and 2000, 148 (27.4%) have been dissolved. In addition, the fact that the number of associations formed each year has been steadily declining since 1997 illustrates the more realistic approach to investing on the island.<sup>4</sup> This is bolstered by the fact that the number of associations dissolved each year has also been signifi-

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1. These comments reflect my remarks at the ASCE meetings supplemented with some foreign investment figures obtained afterwards.

2. The exact figure is \$1,557.6 million, as "reported by government authorities" to a Professor of Economics of the University of Havana. (Omar Everlery Pérez, "La inversión extranjera directa en Cuba: Evolución y perspectivas," presented at the Congress of the Latin American Studies Association (LASA), Washington, DC, September 6-8, 2001, p. 11.)

3. Pérez, p. 10.

4. Pérez, see chart on page 10.

cantly reduced, which means investors are probably doing their homework more thoroughly.

Not much seems to have changed in the investment picture since we met here last year or, in fact, since I began looking at this issue in 1997. The nature of foreign investment in Cuba continues to show certain characteristics:<sup>5</sup>

- It is mostly directed at the export sector and extractive (basic) industries—particularly mining and oil as well as tourism (the primary exception seems to be telecommunications);
- Partly due to the above, partly due to the nature of the economy, dispersion and multiplier effects are very limited. Employment in joint ventures, for example, is 19,800 workers, or less than 0.5% of the workforce.<sup>6</sup>
- Most of what people perceive as foreign investment, a perception abetted by the Cuban government, is really the result of hotel management contracts and foreign representations, not FDI.
- Several very large deals account for the bulk of FDI, the remaining investments tend to be quite small.
- It is very difficult to research this sector properly, due to the continued difficulty in obtaining data that meets international standards on FDI.

What indeed seems to have changed, very obviously since 1997, is the international perception of the Cuban market. Despite continued reports of the exploratory visits of potential investors and delegations of business people from different parts in the globe, the completion of more investment protection agreements and the sort, it has become increasingly apparent that the hype over alleged great business opportunities in Cuba is over. Potential investors, governments and even journalists seem to have sobered quite a bit, faced with the poor economic per-

formance coupled with the failure to liberalize the economy further.

Going forward, especially for whenever Cuba might be ready for the awaited transition, here are some key issues sure to impact foreign investment:

- How to deal with property rights remains a huge challenge for the future. The selection of appropriate formulas—restitution, compensation, substitution—will greatly determine the future climate for foreign investment.
- What will happen with existing foreign joint venture agreements if there is a change in Cuba weighs in the present risk assessment, but will also pose a test for the future. Will existing contracts be preserved, renegotiated or annulled? Will investments be subject to expropriation? If so, will they be compensated? Or, instead, will they face claims for environmental damage, labor exploitation, etc.? Will they preserve their share if current state enterprises are privatized?
- Wage confiscation, resulting from the peculiar system by which workers in foreign joint ventures must be hired and paid through a state enterprise, is still very high (in certain cases up to 99%). Aside from some obvious implications—violation of workers rights and ILO provisions, etc.—the distortion in the labor market and the overall economy arising from differences between what workers actually get paid and what the firms are paying for them has precluded the operation of an important laissez-faire mechanism. Once liberalized, these forces are sure to have an impact in a post-transition scenario.
- Environmental considerations have been reportedly set aside in favor of business considerations. This will have long-term effects not only in ecological terms, but also on the economy and they

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5. Please refer to my previous papers on foreign investment presented at ASCE's annual meetings, particularly the one presented at the 1997 meetings, which contains a more extensive summary of the investment climate. See Maria C. Werlau, "Foreign Investment in Cuba: The Limits of Commercial engagement," *Cuba in Transition—Volume 7* (Washington: Association for the Study of the Cuban Economy, 1997).

6. This likely does not include the tourism sector, where economic associations are prevalent. See Pérez, p. 13.

will dictate the economics of some important potential future investments.

In conclusion, FDI in Cuba today remains little more than an instrument of economic survival, subservient to the imperatives of maintaining political control. Future Cuban governments seeking to increase foreign investment as a tool of true economic development will hopefully keep two very important

objectives in mind. First, maximizing the multiplier and dispersion effects by attracting the “right” kinds of investment. And second, favoring capital and technology transfers, for which Cuba is in dire need. If and how that is done will have much to bear on the nature and development of foreign investment in a post-transition Cuba.