INVESTMENT IN CUBA

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My fellow panelist, Dan O’Flaherty, addressed trade aspects of U.S.-Cuban relations, noting that U.S. exports could increase, perhaps substantially, if the U.S. were to loosen some existing restrictions.

The picture with respect to investment, however, is not as bright or as clear-cut. Obviously, there is real potential for U.S. investment in Cuba especially in such sectors as tourism, energy, and natural resources. Before the 1958 revolution, 75% of Cuba’s trade was with the U.S., and the U.S. accounted for 90% of foreign direct investment in Cuba. In the case of investment, the sectoral breakdown was as follows: services (mostly utilities), 38%; petroleum and mining, 27%; agriculture, 27%; and manufacturing, 8%. Today, of course, there is no direct foreign investment in Cuba.

To permit U.S. investors to return to Cuba, both the U.S. and Cuban Governments would have to dismantle the many existing legal barriers and policy disincentives that they have erected over the years. This is not a case where unilateral U.S. action would necessarily pave the way for a more expansive economic relationship with Cuba. The Cubans would also have to take a number of steps to improve the investment climate there and attract American capital.

What I would like to do today is to look at these barriers to investment and see what, if anything, can be done about them. There are at least three major barriers on the U.S. side that prevent U.S. investors from seeking opportunities in Cuba.

First, of course, is the 1962 embargo that President Kennedy ordered under the Trading with the Enemy Act. The Cuban Democracy Act of 1992 further strengthened the embargo by prohibiting foreign subsidiaries of U.S. companies from doing business in Cuba. Finally, the Helms-Burton Act of 1995 prevents third-country citizens and companies doing business in Cuba from using properties expropriated from U.S. parties. Together, these three actions effectively block all U.S. direct investment in Cuba and even make it difficult for some foreign entities to invest there if there is any question about a U.S. claim to the property in question. Some legal scholars have questioned the constitutionality of Helms-Burton, but the courts have not definitively addressed that question to the best of my knowledge.
Outstanding property claims are probably the biggest obstacle to U.S. investment in Cuba. A settlement of those claims would, in all likelihood, have to precede any lifting of the embargo and a normalization of U.S.-Cuban relations. To date, the International Claims Settlement Commission has certified 5,913 claims valued at approximately $1.9 billion. Claims under Helms-Burton include these certified claims plus claims by U.S. citizens not certified as well as claims by naturalized Americans who were Cuban citizens at the time of the expropriation. Consequently, court battles could complicate any efforts to lift U.S. barriers to investment in Cuba.

But Cuba has created obstacles of its own to inward investment, which the Cuban Government would have to remove or modify to permit U.S. investors to reenter the marketplace. These barriers are less well known to the general public than the embargo or Helms-Burton, but their impact could still be substantial.

Hughes Hubbard and Reed, a U.S. law firm, did an analysis of foreign investment in Cuba some years ago, which is still relevant today and which I drew on in part for these remarks.

Cuba passed its first foreign investment law in 1982, Law 50. That law allows the establishment of an international association contract and a mixed enterprise or joint venture. Foreign participation in any joint venture was limited to 49%. Theoretically, the foreign investor could transfer funds out of the country freely. In reality, few such joint ventures took place under the authority of Law 50 probably because foreign investors seemed to have little interest in a country subsidized by and allied with the Soviet Union.

In 1995, the Cuban National Assembly passed Law 77, the Foreign Investment Act, which guaranteed the transferability of profits to foreign countries, banned expropriation without compensation, and allowed the transfer of ownership to other foreign investors. Law 77 allowed three types of foreign investment: (1) international association contracts; (2) joint ventures; and (3) totally foreign owned companies. Under Law 77, there were no limits on foreign ownership. Theoretically, it could reach 100% through establishment of a foreign company in Cuba or by creating a separate Cuban company to operate the business.

Law 77 did accelerate foreign investment in Cuba but the results were not as impressive, say, as in the Dominican Republic. There were at least four reasons for this:

1. The approval process for foreign investment lacked specific guidelines, although projects that provided capital, established new markets, or created new technologies were favored.

2. Even though 100% foreign ownership was possible on paper, in reality, a Cuban partner was almost mandatory.
3. The Cuban Government insisted on providing the employees hired by the foreign investor through a special entity created for that purpose.

4. Cuba lacked a comprehensive set of laws to govern business transactions and operations – certainly not enough to give much comfort to foreign investors.

In February, I joined by fellow panelists on a fact-finding mission to Cuba sponsored by the Center for International Policy. While there, we had a meeting at the Ministry of Foreign Investment and Cooperation, where officials provided more information about Cuba’s investment regime. What struck us then is the marked difference between the manner in which Cuba treats trade and how it treats investment. Generally, Cuba seems to seek only limited foreign investment on very specific terms. In fact, Cuba is more selective about foreign investment today than it was during the 1990s. As the Cuban officials pointed out to us, the purpose of foreign investment, as they see it, is to provide capital that Cuban companies cannot furnish themselves.

Today, the leading sectors for foreign investment are tourism and basic industries, especially petroleum and mining. Foreign investment in public health and education are banned as “too sensitive.” And while the Cuban officials claimed that they were prepared to work with wholesalers to expand consumer choice, they were adamant about not permitting foreign retailers to establish a commercial presence there. Further, there can be no foreign ownership of land in Cuba.

As a result of these legal obstacles and policy choices, the actual number of foreign companies operating in Cuba has dropped from about 600 in 1996 to some 400 today, although the Cubans argue that the actual amount of foreign investment has increased due to large investments by China and Venezuela.

So, in brief, the obstacles to U.S. investment created by the Cuban Government are great although more selective than the outright ban imposed by the U.S.

Realistically, however, even if both the U.S. and Cuba moved to eliminate measures blocking investment in Cuba, U.S. investors are unlikely to rush in unless there is a significant change in Cuban policies along with the establishment of a more business-friendly regime. One may well ask why, seeing that U.S. investment in China and Vietnam, both communist countries, has increased dramatically in recent years. The answer is simple: market size. Investors may willingly take the risk of operating where investment protection is less than optimal if the commercial benefits warrant it. Cuba’s market is simply too small to attract these investment flows while there is uncertainty about ownership, repatriation of profits, and protection against expropriation.

However, Cuba is not helpless in that regard. It could do what other smaller – and even larger developing countries – have done, that is, to negotiate a bilateral investment treaty or executive agreement with the U.S. Such agreements are important to U.S. business because they help reduce political and country risks. By establishing rules for the treatment of foreign investments and a neutral and objective forum for the resolution of
disputes, investors will feel more secure operating in an investment climate that is transparent, stable, and predictable. Such a move would encourage U.S. investors that might otherwise ignore the market because of its small size. This, of course, is probably a step too far for either government at this time, but it is certainly an option that both the U.S. and Cuba should consider if and when political relations improve.

Let me conclude on that point. Clearly, there are numerous obstacles facing U.S. investors looking at the Cuban marketplace. These are obstacles that both governments have put in place, and it will take a mutual effort to dismantle them. If the political will were there, these obstacles could be overcome. But even then Cuba would have to take additional steps to create the kind of investment climate that would attract U.S. companies.

In short, investment is a harder nut to crack than trade, although it is not impossible. We in the business community hope that the U.S. and Cuban Governments will at the appropriate time seek to resolve outstanding differences so that U.S. business can once again play an influential role in Cuba’s growth and development.