Introduction

Cuba’s development strategy is one of the most compelling examples of state-led policy. In fact, the dedication of the Castro regime to Marxist-Leninist politics and a socialist economy has distinguished Cuba as an extreme outlier on the spectrum of political economy. The collapse of the U.S.S.R., however, and the subsequent dissolving of its Council for Mutual Economic Assistance forced the Castro regime to reevaluate its development policy and, for the first time, actively seek and promote foreign direct investment (FDI). Cuba has refrained, though, from providing a laissez-faire marketplace for these foreign firms and investors, and the Castro regime has been determined to regulate and control this investment as much as possible. This paper will discuss the current climate of foreign investment in Cuba and analyze the results of the country’s policy towards FDI with regards to comprehensive economic development.
Background

After its independence in 1902, Cuba relied heavily on foreign investment and multinational corporations to provide the capital needed to run its economy. In fact, 75% of industrial output was tied to foreign entities by 1925 ("About Foreign Investment in Cuba") and there were total FDI inflows of $345 million between 1947 and 1959 (Jorge 20). However, after Castro nationalized all foreign-owned enterprises and private property, including $1 billion in US-based FDIs (Leogrande, 326), Cuba had a total dearth of foreign direct investment for the next thirty years (Gordon, 108). During this time, the Castro regime consolidated power, implemented full government control of the economy, made possession of foreign currencies illegal, and relied heavily upon the U.S.S.R. for development assistance and foreign trade. The collapse of the Soviet Union, however, brought an end to the Council for Mutual Economic Assistance that Cuba had so heavily relied upon for imports and exports, and the $4.3 billion a year Cuba received in total financial support from the Soviets essentially evaporated (Hernández-Cata 25). This event had extremely negative implications for Cuba’s economy: its GDP declined 35% between 1988 and 1993 (Johns, 38) and its GDP per capita fell to the lowest level since 1973 (Jorge 25).

In order to reverse Cuba’s paralyzed economy and appease a population on the verge of widespread rioting, the Castro regime decided to slightly liberalize the economy and utilize foreign investment for the first time. This decision was not the result of a dramatic shift in economic ideology; rather, the choice was made under severe constraints as other sources of government revenue and economic stimuli were limited.
Cuba, because of its history of debt defaults, nationalizations of foreign firms, and highly controversial politics, is not a member nation of the Inter-American Development Bank or the World Bank and thus has very limited borrowing options, with regards to multilateral development assistance (Travisieso-Diaz 904). The other primary option of remittances played a significant role in the 1990s, serving the country’s “fastest growing hard currency source” of the decade (Eckstein 316). Still, remittances in Cuba have failed to produce “export-based earnings” and are not viewed favorably by the state due to their ability to catalyze Cuba’s informal economy (Eckstein 324). All of these factors contributed to a “grave foreign exchange shortage” and inability to “make [foreign] purchases” (Castro 1993). Put simply, outside of embracing FDI, “the government [had] absolutely no other way of feeding its people” (Molinski 136). Thus, the regime finally acknowledged, “greater opening for foreign investment is one of the solutions we have to tackle [in] the difficult situation we face” (Castro).

As is the case with many of the Castro regime’s policy shifts, Cuba’s promotion of FDI was initiated through a relatively slow process. The first example of FDI in the Castro regime actually began prior to the formal collapse of the U.S.S.R. In 1988, under the authorization of the 1982 Decree-Law 50, a Cuban state-run enterprise partnered with a Spanish firm in the production of a tourist hotel (“About Foreign Investment in Cuba”). Between 1989 and 1994, FDI in Cuba, aided by moderate reforms as well as a more liberal interpretation of Law 50, reached over $500 million largely due to the establishment of some 108 joint ventures (Jorge 19). Foreign investment’s role in the economy was significantly augmented in 1995 by the National Assembly’s passage of the
Foreign Investment Law, or Law 77 (Travisieso-Diaz908), a piece of legislation championed by Castro for its ability to “develop the country” (Castro 1995).

The Foreign Investment Law officially permitted four broad types of FDI: joint ventures, international economic associations, Cuban branches of multinational corporations, and foreign owned companies within Cuba. Joint ventures, utilized in a variety of sectors, couple the capital and technical expertise of foreign investors with the labor and real estate holdings of Cuban entities in a mutually owned enterprise (Ibid 909). At the time, Castro remarked that while “we are not planning or willing to sell our country,” the government was “participating in this adventure” of liberalization to spur economic growth and acquire capital (Castro 1995). With such an attitude, it is unsurprising that international economic associations were initially rather limited, although Castro blamed the slow start on the United States, saying it was “constantly threatening those who do business with us” (Travisieso-Diaz 908). Still, deals have taken off as of late with a proliferation of production and management contracts which were officially permitted in 2000. Production contracts are particularly appealing to foreign investors who are funding labor-intensive industries and are also reluctant to make initial fixed investments of more than a year. Meanwhile management contracts are most often utilized in tourism (Ibid, 911-912). Next, the number of branches of multinational corporations has risen dramatically since this liberalization: as of 2003, there were over 800 such branches (Ibid, 913). Finally, although technically foreign firms can own businesses run entirely in Cuba, this practice remains extremely rare and highly regulated (Ibid).
In addition to establishing these four types of FDIs, Law 77 has also promoted FDI in Cuba by seeking to improve the overall investment climate. For instance, Cuba has established the Ministry of Foreign Investment and Economic Cooperation, streamlined the process of FDI applications, granted the right of repatriation of profits to foreigners, and offered general insurance and expropriation protections (Ibid 913-915). Fortunately for foreign firms and investors operating in the country, Cuba has branched out beyond the Law 77 provisions and continued working on improving the attractiveness of its investment climate. Such developments include the implementation of free trade zones around Cuba’s three main ports, reforms of domestic corporate finance and banking operations, and adoption of bilateral investment treaties with over sixty countries (Ibid 916).

Despite Cuba’s work to improve the attractiveness of its investment climate, political risk on FDI remains due to U.S. sanctions. Specifically, firms and individuals wishing to invest in Cuba must consider the 1996 Helms-Burton Act of the United States. This legislation seeks to limit FDI in Cuba by enabling “U.S. citizens and companies to file lawsuits against foreign companies that do business on properties that were confiscated from them after the 1959 revolution” (Molinski 137). In practice this legislation has not been a notable hindrance to FDI in Cuba from countries other than the U.S., although Cuban officials are quite opposed to this law- Castro has called it “evil” and a violation of Cuba’s sovereignty- and they frequently blame it for turning away potential investors (Castro 1996). Some foreign firms have “been pressured to make deals” with these potential American plaintiffs in order to avoid future litigation and legal dispute over the issue (Roy 298). Naturally, the uncertainty surrounding property rights
due to the aforementioned property expropriations will inevitably become an even more serious concern for foreign investors after the normalization of relations between the United States and Cuba (Molinski 140).
Current Status

Over the past two decades, Cuba’s economic reforms have ushered in an era of significant growth in FDI. The 2007 United Nations Conference for Trade and Development (UNCTAD) estimated that Cuba received net inflows of $16.8 million, bringing them to a total FDI stock of $135.58 million, the highest amount ever recorded in the Castro regime (“Major Indicators of FDI”). This also illustrates Raul Castro’s relatively robust public support of FDI (Erikson 401). Moreover the majority of these investments are geared towards mineral extraction, oil and natural gas exploration, or tourism. To demonstrate a “typical” FDI-fueled enterprise, the Spanish energy giant Repsol-YPF operates a joint venture with Cubapetróleo, a state-owned enterprise, to engage in offshore oil exploration (de las Casas 228).

Despite this growth, some troubling signs have emerged in Cuba’s handling of FDI. Specifically, growth in FDI has not been continuous and was even negative for 2000 and 2003 (“Major Indicators of FDI”). Additionally, it appears that new investments of FDI have been slowing: the number of joint ventures, for example, has decreased from 258 in 2005 to 234 in 2008 (Frank). The U.S. Department of State in fact estimates that “one joint venture and two small cooperative production ventures have closed each week since 2000” (“Background Note: Cuba”).

Another interesting change in Cuba’s FDI is the shift in the origin of capital. Advanced economies have traditionally been Cuba’s most prolific investors: a decade ago, 23% of all FDI originated in Spain, 19% in Canada, and 15% in Italy (Leogrande 345). Today, however, most new FDI comes from countries outside of
the Organization for Economic Co-operation and Development (OECD), such as Venezuela, Russia, China, Brazil, India, and even Malaysia (Morris). For instance, Cuba’s recently invigorated political alliance with Venezuela has produced 24 new joint ventures (Frank). The estimated largest joint venture in Cuba also comes from a Venezuelan firm. Petróleos de Venezuela S.A., Venezuela’s state-run energy conglomerate, has a projected investment of $1 billion in 14 oil and natural gas “refining and storage facilities” (“Foreign Investment in Cuba”). Similarly, China and Cuba are becoming increasingly aligned, with the former having pledged over $500 million of FDI to Cuba at the 2004 Asian-Pacific Cooperation (APEC) Summit (Ellis 18). The two politically similar countries have also initiated an annual “Forum of Chinese-Cuban Investment” to facilitate further such agreements (Ibid).
Analysis

These recent shifts in FDI trends are not coincidental. Rather, they reflect a reversion by the Castro regime to an active, state control of the economy which has evolved into “dense regulations and an impenetrable bureaucracy” (“Background Note: Cuba”). Despite Raul Castro’s investment-friendly rhetoric, the country is turning towards its political allies and away from traditional partners with regards to new FDI. Demonstrating this trend, Cuba has begun declining new applications from companies wishing to operate in the free trade zones (Hemlock). Cuba’s decision to prohibit the use of dollars in transactions with state-owned enterprises and strengthen already stringent foreign exchange controls has been extremely detrimental to FDI flows as well (“Background Note: Cuba”). Additionally, the shift to FDI originating from politically aligned countries is representative of Cuba’s decision to base economic policy off of its national security objectives.

Another manifestation of this strong state control is the Cuban government’s attempt to steer FDI into “targeted” industries, which has prevented both the true functioning of the market and efficient resource allocation (Cruz 3). When sugar prices were rising in 2006, for instance, Cuba solicited FDI for the industry for the first time (“Country Profile: Cuba). A more open FDI climate would have already properly allocated capital to the industry and profits would have been much higher as a result. Similarly, Cuba’s “preference for case-by-case negotiations with potential foreign investors” has also undermined market forces and mitigated FDI’s effectiveness in promoting economic development (Cruz 3).
As a result of such poor management of FDI as well as the ubiquitous political risk associated with investing in the country, the World Bank has reported that European firms investing in Cuba feel, “discriminated against by [Cuban] officials, who arbitrarily apply obscure laws and complex regulations and change agreements when it suits them” (“Foreign Investment Slumps”). The World Bank also reports that these investors view the Cuban enterprises with which they have formed a partnership as “unresponsive to advice and uncooperative” (Ibid). Additionally, Cuba’s “regulatory quality,” arguably the biggest determinant of FDI, has consistently been rated among the lowest in the region (Cruz 3). It is unsurprising then that most experts still consider Cuba to be “one of the most uncertain investments in the region” (Molinski 134). In EuroMoney’s 1994 country risk poll, Cuba was rated 167 out of 167 (Leogrande 345), and in the 2007 poll, the island nation was ranked 180 out of 185 countries (“Country Risk Poll”).

Overall, it appears that Cuba has failed to “secure foreign investment to the degree that the country requires and is capable of attracting” (Travieso-Diaz 944). Simultaneously, the FDI that was present “has failed to produce either widespread economic benefits through inter-industry linkages or dynamic impetus for economic growth through sustained increases in productivity” (Cruz 3). The data backs up such assertions regarding the limited effectiveness of FDI: the Economist Intelligence Unit reports that joint ventures in Cuba account for merely 1% of employment (“Country Report”). In other words, the insufficient nature of economic liberalization and the tight restrictions of FDI have only benefited a small portion of the population and thus perpetuated income inequality: the Gini coefficient increased from 0.22 in 1986 to 0.41 in 1999 (Brundenius 378).
It is still important to realize the gains associated with Cuba’s initial push for FDI and its role in overcoming the crisis of the “Special Period” (Orro 42). As Figure A in the Appendix demonstrates, the rise in FDI has catalyzed a rise in the non-state share of employment, which then turned total factor productivity from overwhelmingly negative growth to positive figures (Hernández-Catá 25). Additionally, the era of reforms has broadened Cuba’s range of exports and trading partners, as the percentage of Cuba’s trade going through Europe or Latin America increased from under 15% in 1988 to more than 73% in 1997 (Leogrande, 358). Correspondingly, FDI has eliminated Cuba’s dependence on sugar exports, thus strengthening its ability to weather volatility in the global commodities markets (Ibid). The exposure to foreign commerce has moreover lead to enhancement in Cuba’s human capital as their businessmen and entrepreneurs have been able to learn from their foreign counterparts (Orro 43). Expanded exposure to foreign economies has similarly helped Cuba develop its domestic technological capability (Ibid).

Perhaps the most successful example of FDI in Cuba is in the tourism industry. This is a result carefully cultivated by the Castro regime (Leogrande 347). In fact, Castro himself has publicly promoted FDI-stimulated tourism in Cuba, saying relatively early in the program: “If we are going to develop tourism, we need capital and foreign investment” (Castro 1993). With investments in tourism accounting for almost 20% of all investment in Cuba during the 1990s, the industry has greatly expanded (Brundenius 384). It grew from drawing a mere 2% of international travelers to the region in 1990 to 9.3% in 1999 (Ibid). This growth has far outpaced that of its neighbors, despite being the only one of its peers that does not have access to American travelers. Furthermore, between
1994 and 2002, tourism produced more hard currency within Cuba and comprised a
greater share of GDP than Cuba’s traditional economic leader, sugar production (Ibid).

It is also of note that Cuba has utilized FDI to promote a general development
strategy of indirect import substitution, just as it did during its long-standing relationship
with the U.S.S.R. (Monreal 78). During this special period, economic self-sufficiency
was emphasized as a primary goal (Leogrande 343). Cuba essentially utilized income
from FDI enterprises to reinvest in the country by “upgrading local supplier industries”
(Brundenius 380). Interestingly, these policies appear to have been relatively effective, as
local suppliers have seen their sales substantially increase (Ibid). FDI has thus not only
filled the void of capital in Cuba, but it has also enabled the country to maintain its
overall development strategy of import-substitution. This is undoubtedly pleasing to the
Castro regime, which has traditionally viewed political and economic independence as
imperative governmental objectives.
Conclusion

In responding to the domestic depression spurred by the collapse of the Soviet Union, Cuba had little choice but to engage in a period of economic reform. The Castro regime moderately liberalized the economy throughout the nineties, and, for the first time, permitted and even promoted foreign direct investment. However, when the economy began to stabilize, the regime slowly reeled back these reforms and began reorienting their trade and investment relationships with more politically aligned countries. It is unsurprising that Castro, as an avid Marxist-Leninist, did pull back on these reforms, as his reluctance towards economic liberalization was quite palpable throughout this period.

While the expansion of FDI in Cuba was advantageous, its ability to actually transform the economy and extend its benefits to the majority of the populace was severely constrained by ill-advised government regulations and control. Fortunately however, the progress that Cuba made has not been completely lost. It would not be particularly burdensome for Cuba to make a concerted effort, through “suitable government initiatives,” to address their shortcomings in the treatment of FDI and thus substantially alter the negative perceptions and timidity of foreign investors (Travieso-Diaz 944-945). With such action, an era of comprehensive economic development could be ushered into Cuba, though, the regime’s political philosophies could prevent such action. Let us hope that this will not be the case.
Appendix

Figure A- Total Factor Productivity and Non-State Share of Employment

Source: Hernández-Catá, 25
Works Cited


