

Foreign Investment In Cuba: A US Perspective

By: Antonio R. Zamora

Cuba, the largest island of the Caribbean with a population of close to 12 million and a land area of just over 45,000 square miles, roughly the size of the state of Florida, is considered by many to be an important future trade and investment partner for the United States. This is particularly true for Florida and other Southern-gulf states, such as Texas and Louisiana. Cuba's potential as a US business partner and, particularly, as a target for US direct investment has been the subject of numerous seminars, conferences, articles, reports and studies in recent years.

The interest in Cuba that US business and professional groups have shown results from the realization that the US embargo that forbids most business transactions between US and Cuba is starting to show signs of serious wear and tear. The prohibition on US business transactions with Cuba is the result of the economic restrictions imposed by President John F. Kennedy in 1962. Kennedy's actions taken at the zenith of the Cold War was based on the Trading with the Enemy Act of 1917. In the nineties, Congress acted to strengthen the embargo by adopting the Cuban Democracy Act of 1992 (commonly called the Torricelli Law) which prohibits foreign subsidiaries of US companies from doing business with Cuba and the Cuban Liberty and Democratic Solidarity Act of 1995 (commonly called the Helms-Burton Law) which attempts to punish citizens and companies from third countries doing business in Cuba utilizing properties expropriated from US parties and codified the embargo.

In the last couple of years, however, Congress has shown a willingness to reconsider its position towards Cuba. This has been due to three things, basically. First, a general frustration

with a unilateral economic sanction that has been ineffective in achieving its objectives. Second, a national willingness to have normal trading relations with countries, such as China and Vietnam which makes it hard not to do the same with Cuba. Third, strong lobbying efforts by US business interests pursuing new markets coupled with a relative weakening of the pro-embargo forces.

As the result of these new factors, several laws were introduced in Congress in 1999 and 2000 directed at terminating or softening the embargo. The law, given the best chance of being enacted, will terminate unilateral sanctions affecting food and medicine involving several countries including Cuba. This legislation was approved by the Senate by a wide margin and has 220 sponsors in the House. The Executive Branch has also indicated a willingness to modify restrictions on Cuba. In early 1999, President Bill Clinton announced substantial liberalization of travel and communications restrictions affecting Cuba. It is expected that further liberalization measures will be put in effect before the end of the present administration.

With the increasing prospects for the normalization of relations between US and Cuba, it seems worthwhile to review foreign investment in Cuba from an American prospective. After all, prior to the Revolution, 75% of Cuba's foreign trade was with the United States and over 90% of the direct foreign investment in the Island came from US companies and individuals. This investment was approximately US\$ 1 billion in 1958. The sectoral breakdown was: 38% in services, mostly utilities; 27% in petroleum and mining; 27% in agriculture; and 8% in

manufacturing. US properties in Cuba were expropriated during the early 1960's; the issue of compensation to date remains unresolved.

Prior to the Revolution, Cuba was totally open to foreign investment. Foreign companies desiring to do business in Cuba simply had to register to do business and comply with local laws. There were no special restrictions. During the the 1960's and the 1970's, Cuba was too busy building socialism, integrating with the Soviet Bloc and enjoying its US\$ 6 billion yearly Russian subsidy to consider foreign investment. The Cuban government began to look at foreign investment from non-communist countries in the 1980's when the economic failures of the Soviet Bloc became evident. In February of 1982, the first foreign investment law of Cuba's revolutionary period was enacted. That law was Law 50 of 1982, entitled: "Regarding Economic Associations Between Cuban and Foreign Entities."

The language of Law 50 is very vague and tentative. These qualities are clear in its introduction which makes reference to informal associations, lack of regulation and "*de facto*" activities. Law 50 contemplated two types of legal structures for foreign investment: an international association contract and a mixed enterprise or joint venture. Investments under Law 50 had to be approved by the Council of Ministers and foreign participation was limited to 49%. Profits generated by the foreign investment could be freely transferred abroad.

In its early years, Law 50 was remarkably unsuccessful in promoting foreign investment. In fact, the first joint venture between a Cuban company and a foreign company did not occur until late 1987. There were essentially two reasons for this. First, Cuba's economy was still

being subsidized by the Soviet Bloc, and second, foreign investors had little interest in a small country generally perceived as an entrenched radical ally of the Soviet Union. Both of these reasons disappeared with the collapse of the Soviet Union and the Soviet Bloc.

The collapse of the Soviet Bloc caused substantial damage to Cuba's economy. For instance, between 1989 and 1993, gross national product was basically cut in half, the Soviet subsidy completely disappeared, unemployment tripled, exports dropped 75% and imports 80%. Faced with a crisis of great proportions, the government turned to economic reform and foreign investment in order to survive.

During the first six years of Law 50, only one foreign investment was actually approved in Cuba. During the second six years, over 100 foreign investments were approved. Obviously the mood had changed bringing with it a new law: Law 77 enacted in September of 1995. In contrast to the old, Law 77 is direct and to the point. For example, its name: the legislation was named "The Foreign Investment Act."

Law 77 was enacted by the National Assembly while Law 50 was enacted by the Council of State. The National Assembly is the supreme organ of power in Cuba. It is the only high-level entity elected directly by popular vote and it is equivalent to the legislative power in the Western legal tradition. In addition, Law 77 was extensively debated at all levels of the Cuban society. As a result, acceptance and support for foreign investment is found throughout Cuba. Law 77 was written to create a new chapter on the legal and constitutional history of Cuba. To complement Law 77, the Ministry of Foreign Investment and Economic Collaboration was

formed in April of 1994. The new Ministry was given the task of promoting foreign investment in the Island and a seat in the powerful Council of Ministers.

Law 77 is more comprehensive than Law 50. It contains 17 chapters and 57 articles, whereas Law 50 only had 5 chapters and 44 articles. Moreover, Law 77 is intended to be complemented with further legislation on such matters as banking, real estate and duty free zones. Law 77 not only guarantees transferability of profits to foreign countries, as does Law 50, but also guarantees no expropriation without compensation and the right to transfer ownership to other foreign investors, and provides protection against claims of third parties under Cuban law.

Under Law 77, there are three forms of foreign investment allowed: (1) international association contracts, (2) joint ventures, and (3) totally foreign-owned companies. Moreover, in the joint ventures, there is no limitation of foreign ownership, Law 50 was limited to 49%. Foreign ownership may reach 100%. This can be accomplished by either establishing a subsidiary of a foreign company in Cuba or creating a separate Cuban company to operate the business.

Both laws, Law 50 and Law 77, require a process of negotiation and approval before foreign investment is authorized. Investments of more than US\$ 10 million, 100% foreign ownership, those involving a foreign country, those using natural resources, or that convey either government-owned property or projects involved in certain special sectors, such as: transportation and communication, require the approval of the Council of Ministers' Executive

Committee. All other investments are approved by a Commission created for that purpose by the Council of Ministers.

Law 77 accelerated foreign investment in Cuba. Results have been substantial but not spectacular if compared with other Caribbean countries, such as: the Dominican Republic. At the end of 1999, approximately US\$ 4 billion had been committed by investors from over 40 countries to projects in Cuba. However, only about US\$ 2 billion had actually been invested. By the end of 1999 almost 400 joint ventures were in operation in the Island. Most projects were in the tourism sector followed by petroleum and mining and communications.

Spain is the leader among the investing countries with approximately 23% of the joint ventures, followed by Canada - 20%, and other Latin American countries, principally Mexico, - 18%. Other countries with substantial investments in Cuba are Italy, France, the United Kingdom and the Netherlands. To complement Law 77, Cuba has signed bilateral agreements for the protection of foreign investment with more than 40 countries. These agreements provide mutual equal treatment for foreign investment, facilitate repatriation of profits and establish procedures for the arbitration of disputes. Cuba had signed three tax agreements at the end of 1999, with six more expected to be signed in the year 2000, for the principal purpose of avoiding double taxation.

While Law 77, the bilateral treaties and other measures have improved the climate for foreign investment in Cuba, there exist several serious problems. For instance, the approval process lacks specific guidelines, although projects that provide capital, create new markets and

introduce new technology are favored. Another problem is that, even though it is possible to have a 100% foreign-owned operation, in reality a Cuban partner is almost mandatory. Furthermore, most employees hired by the foreign investor are provided by the Cuban government through an employment entity created for that purpose. A final drawback worth mentioning is that Cuba lacks a comprehensive set of business laws to govern business transactions and operations. Certainly some progress has been made in this respect, but not enough, to provide comfort to the contemporary investor.

Law 77 contains two new important developments in Cuba's foreign investment legislation. First, the law authorizes the establishment of duty-free zones and industrial parks open to investment by foreigners. According to the law, the free zones and the industrial parks shall operate under a special system covering custom duties, exchange rates, taxation, labor, migration, public order, capital investment, financial operations, storage, production, manufacturing and foreign trade. In due course, Law 165 of 1996 was enacted to implement free trade zones and industrial parks regulations under more flexible investment and operational rules. Three free trade zones and several industrial parks have been created since Law 165 went into effect. The success of these special areas, however, has been quite limited and will remain so until such time as trade with the US is reestablished because there isn't much manufacturing, assembly or storage business under present circumstances.

Second, Law 77 provides that foreigners may acquire ownership and other property rights over Cuban real estate. The areas of investment are limited to: real estate development in the

tourism sector, housing or offices of foreign companies established in Cuba and residences and other housing structures dedicated to private residences or private tourism activities for individuals who do not permanently reside on the Island. Because of this, since 1996 several commercial and residential projects have been constructed in Havana and there are plans for residential developments, including timeshares, in other regions of Cuba.

The commercial developments in Havana include the rehabilitation of the old *Lonja del Comercio* (“the Commodities Exchange”) Building in Havana’s historic center which resulted in 140,000 square feet of modern business offices and the Miramar Trade Center located in the prestigious Miramar section of the City which will have, when completed, almost 2,000,000 square feet of offices, stores and parking area. In addition, there have been several shopping centers and warehouses built as a result of Law 77 and more are planned.

The residential developments include a series of small condominium projects with less than 100 units and one larger project, the *Jardines de 5ta. Avenida* (“the Gardens of 5th Avenue”), with 175 units. Almost all of these condominium projects are located in Havana’s Miramar area. The first project completed, the Montecarlo Palace, sold out quickly and everything indicates that the other projects are also substantially sold out. In spite of the success of condominium sales, in March of 2000 the Cuban government declared a moratorium on the approval of future condominium projects. Existing projects will be allowed to proceed as planned, except that all unsold units will be purchased by the Cuban entities that are partners in

the joint ventures developing the projects. The apartments purchased by the Cuban entities will then be placed in a rental pool.

Cuban officials gave two main reasons for the moratorium. First, infrastructure problems, particularly those related to water and sewer. This is certainly a valid reason. In general, Cuba's urban infrastructure is in bad condition, mostly because of age, poor maintenance and over use. Second, lack of a comprehensive real estate law addressing condominium ownership, financing, registration of titles, timeshare ownership, mortgages and other necessary real estate issues. This is also a valid reason although a comprehensive real estate law has not been enacted because the government has placed a hold on it. It appears that the unofficial reason for the moratorium is that private ownership of luxury condominiums in a socialist country, especially during a period of economic hardship, must be carefully evaluated and controlled. It seems that free trade zones and industrial parks are not as controversial, therefore the enabling legislation, Law 165, was enacted within a year of Law 77's. The only important real estate related law passed by the Cuban National Assembly since 1995 was the Public Registry Law adopted in July of 1999. This important law revitalized Cuba's registry of properties system and made registration of titles mandatory for both residents and non-residents. The general opinion is that the moratorium will not end private ownership of condominiums in Cuba, it will only slow it down. In the meantime, timeshares, apartment-hotels and leasing can go forward without restrictions and, eventually, the comprehensive real estate law will be enacted.

It is, of course, impossible to discuss foreign investment in present day Cuba without mentioning the issue of property claims by those individuals and entities whose property was expropriated by the Cuban government in the 1960's. There are three categories of former owners, classified according to their legal status at the time they lost their property: (i) US citizens and US companies, (ii) Cubans who adopted US citizenship, and (iii) Cubans who either remain Cuban citizens or were naturalized citizens of countries other than the US.

Claims of US citizens and companies are based on the International Claims Settlement Act of 1949 and the Helms-Burton Act of 1996. International law requires that governments pay compensation to foreigners for property expropriated by them. The Cuban government has indicated, on many occasions, its willingness to negotiate the compensation issue with the United States. Cuba has settled the issue of expropriated properties with several countries, including: Spain, France, Italy and Canada. Certainly before the US embargo is terminated and relations between Cuba and the US are normalized, the issue of expropriated property will have to be settled.

Claims under the International Claims Settlement Act are certified by a settlement commission to the Secretary of State for use in future negotiations. Settlement of the claims will not result in restitution of the property but rather a payment of a negotiated sum of money. The property rights of the new owners should not be affected. Once a settlement amount is reached between the two countries, the certified claim owners are paid proportionately. The total

certified claim amounts to almost US\$ 2 billion in principal only and there are approximately 100 principal claimants.

Claims under Helms-Burton include, not only those certified by the Settlement Commission to the Secretary of State, but also by US citizens who are not certified, as well as claims by Cubans who were Cuban citizens at the time of the expropriation, who later became naturalized US citizens. Action by the President is required before enforcement of the Helms-Burton Act. President Clinton has repeatedly waived the application of the Helms-Burton Act. It is also very likely that if the claim provisions of the Helms-Burton Act are tested in a court of law, they will be found unconstitutional.

Cubans who became US citizens after their properties were expropriated and Cuban citizens, whether living in the Island or in the US, or in any other country, are not protected under international law and their claims will be a matter to be resolved entirely under Cuban law. It is not reasonable to expect, without a major political change, that the Cuban government will nullify its own expropriation policy and return expropriated properties to their former owners. In the future, there may be in the future some sort of conditional restitution or some form of modest compensation to encourage development. In the meantime, investors in Cuban real estate should investigate prior ownership and factor same in the investment equation. This should result in an evaluation of the risk involved with the property due to potential claims. The option of reaching some form of settlement with potential claimants prior to the investment should also be considered. The most famous example of this option was the agreement reached between the

Italian communications firm, Stet, and IT&T, before Stet's investment in Cuba's telephone system whose facilities were expropriated from IT&T by the Cuban government in 1960.

Other than negotiating claims with foreigners who are investing in Cuba, Americans may, and do, in fact, participate in certain business activities, specifically exempt from the embargo. These include: telephone service, charter flights and delivery of mail and certain types of permitted goods from the US to the Island. In addition, Americans may invest as minority non-controlling shareholders in foreign companies doing business in Cuba, provided that such companies do more than 50% of their overall business outside of the Island.

Once the embargo is terminated and relations between US and Cuba restored, the business potential for Americans is very substantial. This potential is nowhere near that of China but certainly surpasses that of Vietnam. Some of the projections are 50 flights per day, from South Florida alone, practically all cruise ships based in the Eastern half of the US visiting the Island, as much as 7 or 8 million US visitors per year, annual trade in the 5 to 6 billion dollar range, and a real estate development boom of great magnitude. This boom will be the result of the construction of several hundred hotels to accommodate the increasing tourism, approximately 200,000 new housing units to be used by Americans as second homes, retirement homes, and company or business facilities, at least 500,000 housing units to satisfy local needs and the infrastructure to accommodate the residential and business expansion. When all of this happens, the US gain will play a very important role in Cuba's economy but it will not be as dominant as before 1959.