Council on Hemispheric Affairs

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Cuba's Dire Need for Foreign Investment: What it means to its Developing Economy

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Since the collapse of the Soviet Union in 1989 and Cuba's subsequent hardship while transitioning to a more decentralized economy in its "Special Period," Cuba has implemented significant economic changes. While preserving socialist gains accomplished during the Revolution, it has continued to develop elements of capitalism first employed by Fidel Castro in response to severe economic times in the 1990s. Cuba has undergone a series of recent transformations in its ability and willingness to attract the kind of foreign investment that is essential in developing and sustaining economic growth.[1]

Until Fidel Castro began decentralizing state economic control by allowing inflows of foreign capital and other outside investment, the Cuban economy contracted drastically. After the Soviet Union began to dissolve in 1989, Cuba suffered an immediate 75 to 80 percent drop in foreign exchange receipts as Soviet subsidies dried up.[2] Per-capita income contracted by 34 percent from 1990 to 1993 because of a lack of foreign investment and access to international financial institutions, coupled with a hardened U.S. trade embargo.[3] Since that Cold War period, Cuba has continuously opened up to foreign investment and has used it to develop struggling elements of the economy. As the Cuban government's control of the economy has gradually diminished, the island nation has seen tremendous improvements in its ability to increase and sustain economic growth.[4]

However, Cuba's economy is still lagging. According to the Brookings Institute, decades of international experience have shown that strong growth in gross domestic product (GDP) is necessary for achieving development, and this has been a significant issue for Cuba. Cuba's GDP has grown only about 1.8 percent a year over the past two decades, a rate that has made Cuba one of the lowest-performing countries in Latin America.[5] The Cuban communist newspaper, *Granma* (March 31, 2014), quoted a government commission acknowledging that "no country today has successfully developed without foreign investment as a component of its political economy."[6]

So the government has sought to attract a larger pool of foreign investors, but to lure them it needs to make more compromise by gradually reducing restrictions.

Recent Steps by Cuba: Putting Mexico and South Africa on Board
Mexico:

Cuba has not fully utilized its economic capabilities, abundant natural resources, and strong diplomatic relations, all of which can be improved by foreign investment. President Raúl Castro has sought to ensure that Cuba puts itself in the best light possible to entice investors.

In November he visited Mexican President Enrique Peña Nieto in an effort to strengthen diplomatic relations and create conditions allowing for increased Mexican investment in Cuba. This could help both countries as each has much to offer in terms of natural resources and willing investors.
Federico Martinez, president of the Mexican construction firm Tradeco, is one potential investor who sees tremendous opportunities in Cuba. Martinez says Cuba "needs lots of infrastructure: highway infrastructure, communications infrastructure, hydraulic infrastructure" and can offer "many opportunities for companies."[7]

Improved and modernized infrastructure would be highly beneficial to Cuba and potential investors alike, by cutting transaction costs and contributing to the competitiveness of their goods and services.[8] Underdevelopment in Cuba's infrastructure is evident in its railways and coastal transport, technologies and systems for storage and handling of freight, public transportation, and in cellular telephones and data transmission.[9]

By gradually decentralizing government control in these areas and opening to private investors, Cuba can be significantly more competitive in attracting and sustaining foreign investment. President Castro recognizes the value of Mexican investors willing to contribute to his country's potential by building badly needed infrastructure. His recent negotiations with Mexico to create favorable conditions for more Mexican companies to invest in Cuba is a step in the right direction.

South Africa Expresses Interest in Investment

South Africa has expressed similar interest in expanding its investment in Cuba. South African Deputy Minister Mzwandile Masina led a group of investors and exporters in November on a mission to Havana and expressed pleasure with Cuba's potential to absorb trade and investment.
"I can safely say to the people of South Africa in general and the businesspeople in particular," he said, "that Cuba is fast developing and the time to come and invest in this country is now. A great number of good opportunities have been identified that people across the world want to take advantage of. Our companies should not be left behind."[10]

South African Vice-President Cyril Ramaphosa said he expects exchanges between businessmen of both countries to help promote and diversify economic cooperation in new areas of mutual benefit.[11]
Mesina said his government would help South African companies establish joint-ventures and partnerships in Cuba. Opportunities there including tourism, construction, infrastructure development, agro-processing, renewable energy, transportation and healthcare are all on the radar for South Africa

as it continues to be seen as a significant future business partner. Cuba has strong political ties with South Africa, and creating increased long-term investment would be an incentive to both countries to build on the foundation already created.

FIHAV and a Vital U.S. Presence

To further attract foreign investment, the Cuban government has recruited investors through its successful International Trade Fair, or FIHAV. More than 1,500 enterprises from 57 countries and territories around the world attended the Havana event in early November. More than 350 Cuban companies showcased what they can provide, mostly in health care, food processing, electronics, civil engineering, construction, and services.[12]

Most important was the U.S. presence at the fair. Among the companies attending, Sprint and PepsiCo showed great interest in doing business in Cuba. Because of President Barack Obama's gradual chipping away at the embargo by creating a telecommunications exemption, Cuba has signed a roaming agreement with Sprint Corporation "to allow customers...to easily make wireless connections when in Cuba," according to Computerworld, which noted that the agreement followed a similar one with Verizon.[13] This signifies considerable progress between the two countries, but the only partially reduced embargo still hampers U.S.-Cuban trade and investment. Provision of services by U.S. companies like Sprint would represent a big opportunity for both countries. Not only is the United States a world leader in the supply of advanced technologies and a major source of investment flows, but the fact that its companies account for nearly a quarter of world imports makes it a crucial potential partner for Cuba.[14] Cuba realizes the importance of large U.S. investors, but many compromises are necessary for significant progress in fully ending the commercial, economic and financial embargo.

Cuba would benefit immensely from the lifting of barriers like restrictions on U.S. companies' ability to invest and receive imports from industries outside of agriculture and medicine and to make incentivizing credit terms on imports and exports. But until it satisfies provisions of the Helms-Burton Act Congress is unlikely to lift the embargo. Cuban obligations under the 1996 act include transitioning to a democratically-elected government, reimbursing for expropriations made during the Cold War, and releasing all political prisoners in Cuban jails.

Although President Raúl Castro has claimed that Cuba has made sufficient progress, Washington is insufficiently impressed. This was exemplified in October when a Cuban-initiated resolution in the UN's General Assembly to end the embargo was again rejected by the United States.[15] (The vote was 191-2.) President Obama favors ending the embargo and has taken consistent steps to diminish it, but Congress hasn't budged.

Republicans in Washington, however, are likely to yield at least slightly to growing pressure from American businesses looking to get a foothold inside Cuba.[16] Most notably are the American farmers eager to sell their products to a Cuba in desperate need of foreign agricultural imports. U.S. Wheat and rice farmers urged the Senate Committee on Agriculture, Nutrition and Forestry in April to create legislation to lift the embargo, noting its interests favoring abolishment could create immense potential for their industries. Terry Harris, senior vice-president of marketing and risk management at Riceland Foods, Inc., told members the United States "could regain 20 to 30 percent of the Cuban rice business within two years, or an estimated 90,000 to 135,000 tons of new demand for U.S. farmers." "We would anticipate the U.S. share of the market would exceed 50 percent within five years and could reach 75% or more within 10 years," he said.[17]

Kansas Wheat Commissioner Doug Keesling, a farmer himself, referred to the U.S. government's excessive entanglement in Cuban-U.S. trade relations and its tendency to deter businesses from Cuba. He says U.S. "regulations and statutes … make U.S. wheat too expensive to compete with wheat from Canada and the European Union in the Cuban market.... The law requires that exporters receive cash before they're allowed to unload in a Cuban port."[18] Requiring cash hand over fist in Cuban ports makes it difficult for businesses because most Cuban purchasers do not have sufficient cash and must take out loans, which the Cuban government prevents Cuban businesses from doing with U.S. lenders.

American industries in general have a significant interest in doing business with Cuba but have yet to show sufficient influence with Congress over the embargo. Even if it were lifted, the Cuban government would most likely impose increased regulation on competition, which it has repeatedly avoided in the past. It is willing to give some ground to private enterprise by decentralizing parts of the economy to accommodate foreign investment but insists on retaining Cuba's socialist nature.

Will this principle prolong the embargo's existence? Washington has left the ball in Havana's court by making significant reductions in the embargo and has eased diplomatic relations by reopening its embassy in Havana. It now awaits Cuba's response. Hanging in the balance are opportunities from one of Cuba's largest and most potentially beneficial trade partners.

Wooing major U.S. companies

Although Cuba recently created incentives for foreign investment, many investors are still uncomfortable about the potential risks of doing business in Cuba entails. The Cuban government's control of markets through its state-generated monopoly on Cuban goods over imports and exports and its dual currency that allows for manipulation of wages both create disincentives for efficient plant production. Its control of hiring of workers and of manufacturing plants' operations capacities limits the country's attractiveness for foreign investors.[19]

Jones Lang LaSalle (JLL), a firm specializing in commercial real estate and investment management and ranked by Forbes as one of the 500 highest-earning U.S. companies, addressed these concerns in a report, noting that "there are a lot of impediments in the way" and that "it is like a double-edged sword: there are opportunities but with a very high risk."[20]

The privately held shipping company Crowley Maritime Corporation, of Jacksonville Florida, which has done business in Cuba for 14 years, is also unsure about the future business climate there. Jay

Brickman, a Crowley vice-president, posed these questions for potential investors seeking to do business in Cuba: "How guaranteed is your investment? Are you sure that you can make profits? Are you sure that there will be no confiscation of your industry?"[21]

From its recent creation of the Mariel Zone, which serves as a favorable location for businesses in the export market, to the promulgation of a new investment law increasing economic incentives for companies seeking to do business in Cuba, much vital change has already taken place in the Cuban economy. Observers continue to ask how much leeway Havana will give to foreign investors as it continues to embrace many of its socialist policies.

Another key question is how Cuba will maintain solidarity with other Latin American nations while moving forward as a developing economy in the world. For the past ten years Cuba has been a member of the ALBA-TCP (Bolivarian Alliance for the Peoples of our America), originally created to help members confront the power of developed countries such as the United States by providing an alternative to the conventional capitalist trade models of privatization and globalization.[22] Cuba's ALBA-TCP membership is another indication of its reluctance to be dependent on global capital markets that do not further its revolutionary goals.

President Raúl Castro emphasized at the Summit of the Americas in April that Cuba is "advancing towards a process of Latin American and Caribbean integration through CELAC, UNASUR, CARICOM, MERCOSUR, ALBA-TCP, SICA and the Association of Caribbean States." Cuba's solidarity with member states of these organizations, he maintains, "highlights a growing awareness of the need to unite to ensure our development."[23]

Cuba, however, must look beyond its relationship with ALBA-TCP nations if it is to continue to develop. Most of its external financing is derived from ALBA-TCP countries -- particularly Venezuela, which is enduring a significant economic and political crisis and whose continued favorable terms on oil exports to Cuba could diminish.[17]

Cuba could use help from international financial institutions (IFIs) including the International Monetary Fund, the World Bank, and the Inter-American Development Bank to transition to a more stable economic model capable of attracting foreign investment.[24] IFIs hold enormous potential for Cuba and would enable it to more easily enter global markets and provide it with the assistance and the adoption of international best practices such as modernizing agriculture, improving communications networks, and enhancing its tourism sector.[25]

In the past, Cuba has rejected these institutions and interventionist agreements, mostly on the basis that their practices are incompatible with its socialist ideology. Over the next few months Cuba will show whether it maintains its solidarity with other nations in the ALBA-TCP while keeping itself open to opportunities present in IFIs and other foreign investment -- and if so, how. As the United States continues to soften or eliminate sections of the embargo and as President Obama's tenure comes to end, Cuba must make decisions while there is momentum. Washington and Wall Street would like to see

Cuba gradually open itself to global capital markets and show interest in IFIs, which could benefit Cuba in the long run and add needed momentum to end the embargo.

Importance of Foreign Investment as Cuban Trade Continues to Develop

Among the challenges Cuba faces as it continues to develop its economy, it needs to develop its agricultural sector for the country to become less reliant on imports from other countries. This would help Cuba use its workforce more efficiently and provide its people with more and better jobs, according to the Association for the Study of the Cuban Economy (ASCE).[26] To lessen a dangerous dependence on a faltering Venezuelan economy, Cuba must continue to open up joint ventures in extracting petroleum from on-shore and off-shore blocks. It must also develop its own technology and infrastructure to ease communication among its citizens and between them and foreigners and enable interaction through social media. Although these challenges can be overcome through foreign investment, that will be difficult to overcome as long as the Cuban government is overly resistant to U.S. interference.

As Cuba defends its socialist revolution while decentralizing some aspects of its economy, it will have to show how it can use its people and natural resources to maximum advantage to obtain the capital necessary to develop itself as a nation. This goal is achievable by Cuba's becoming less dependent on trade with ALBA-TCP countries. In gradually opening itself to global capital markets with the help of IFIs and improving diplomatic relations by negotiating favorable trade terms with countries outside of ALBA-TCP, Cuba can obtain the necessary foreign investment to develop and sustain economic prosperity.

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