FDI in Cuba

Communist State, Capitalist Tool, and the Struggle for Credible Commitment

A Case Study on the Institutional Challenges Cuba Faces When Using FDI as Development Strategy

Jonas Walsøe

Supervisor: Leiv Marsteinreted

Master’s Thesis in Latin American Studies
Department of Literature, Area Studies and European Languages
Faculty of Humanities Studies

UNIVERSITY of OSLO

Autumn 2015
To my loving wife

Jany,

and my supportive family.
Acknowledgements

I would first like to direct my gratitude towards my supervisor Leiv Marsteintredet, who has always found time to evaluate, and to give his feedback, during the process. Without his concrete and his direct comments I would not have been able to construct, and structure, a thesis based on this topic. Furthermore, I would like to thank Vegard Bye for letting me contribute to the conference on Cuba’s future at Voksenkollen konferansesenter, Oslo 2015. The conference gave me the opportunity to exchange information and retrieve knowledge from some of the best academics within Cuban studies. I also would like to extend my gratitude to Ricardo Torrez Pérez at the “Centro de Estudios de la Economía Cubana de la Universidad de La Habana” for keeping in touch throughout the thesis, providing me with information on studies concerning Cuba’s economy and always answering my e-mails. I am grateful to Benedicte Bull, the center of development and environment (SUM), and the NorLARNet master course for providing a platform for master students studying Latin America. Thanks to Ingunn Aronsen for proofreading the language and helping with linguistic challenges under the construction of this thesis.

Thanks to all of my fellow master students at the faculty of Humanities 8th floor for interesting conversations, suggestions and support during the last two years. To all professors that have lectured at the Latin American and Spanish language studies at UiO, I appreciate that you kept your doors open and have been willing to help and discuss important elements of the thesis with me and that you always engage in small talks upon greetings.

Finally, I would like to thank “Omsorgspartner A.S.” for giving me the flexibility I needed as I combine full time work with studies.

It should be noted that the arguments, results and conclusions of this thesis are all my own. They do not reflect, or represent, the views or positions of the persons mentioned above.
Abstract

Foreign Direct Investment (FDI), institutions and “credible commitment” are three terms that relate to one another. The perfect harmony between them can lead to great fortune and prosperity, but if one is absent, too weak or faulty, the dynamics break down and this lead to unsatisfying results. FDI has often been applied as a development strategy by developing countries. The strategy implies an opening of markets and economy, but the necessity of strong and stable institutions, and a certain level of credible commitment, is evidently important to achieve a successful application in the same countries. The Cuban case is comparable to some cases in the Asian region (Vietnam, China), but the results have so far failed to materialize on the Caribbean Island.

This thesis seeks to address Cuba’s ongoing search for FDI to acquire capital that can sustain their rigid socialist system. The thesis explores the obstacles the system and institutional framework provides for foreign investors, and the processes for investment, which again affects Cuba’s credibility.

A central argument throughout the thesis is that for Cuba to further develop their FDI sector, they need to improve their credible commitment, their investment environment, and the informal norms and rules within the institutions that handle FDI. The main issue is related to how they maneuver within their own system of norms, rules and laws. Cuba is a single-party state, and all power rests with the party and the leaders, there are no other powers that can control the Cuban Communist Party (CCP) and the authorities. This gives the government the possibility to do as they see fit in cooperation with foreign investors. Also, as the world is approaching Cuba with propositions and guidelines in a period of transition, Cuban authorities stress to underline that the ongoing transformation is progressing within a Cuban context. It is not a complete change of the political and economic system to comply with international understandings of democracy and economy. Cuba wants to find their own way, experimenting with possible wealth accumulating strategies to finance and develop the “Cuban Socialism”.
# Table of Content

1 Introduction ................................................................................................................................. 1
   1.1 Background: FDI in Cuba ........................................................................................................ 3
   1.2 Defining the Case ..................................................................................................................... 4
   1.3 Objective and Research Questions .......................................................................................... 5
   1.4 Overview of the Thesis ............................................................................................................ 6
2 Theoretical Framework .................................................................................................................. 8
   2.1 FDI ........................................................................................................................................ 8
       2.1.1 Authors and relevance ....................................................................................................... 8
       2.1.2 Functionalities of FDI ...................................................................................................... 9
       2.1.3 Spillovers .......................................................................................................................... 11
       2.1.4 Does FDI work? ............................................................................................................... 14
   2.2 Conditions for FDI to work .................................................................................................... 20
       2.2.1 Credible Commitment ...................................................................................................... 21
       2.2.2 Institutions ....................................................................................................................... 23
       2.2.3 Formal/informal norms and rules .................................................................................. 26
       2.2.4 State/economy/ & society/cultural heritage .................................................................... 29
       2.2.5 Level of commitment and liberalization ......................................................................... 32
   2.3 Summary ................................................................................................................................ 33
3 Methodology ................................................................................................................................. 37
   3.1.1 Why a Case Study? ............................................................................................................ 37
   3.1.2 Research Design ................................................................................................................ 39
   3.2 Sources of Data ....................................................................................................................... 41
       3.2.1 The Unit of Analysis ......................................................................................................... 42
       3.2.2 Validity and Reliability .................................................................................................... 42
   3.3 Collecting the Data .................................................................................................................. 43
   3.4 Analyzing the Data .................................................................................................................. 45
   3.5 Biases and Limitations ............................................................................................................ 47
4 Cuban Political, Economic and Cultural Context ......................................................................... 49
   4.1.1 Towards Communism: the emergence of Cuban Socialism .............................................. 50
   4.1.2 Cuba in Transition .............................................................................................................. 58
   4.1.3 Summary ............................................................................................................................. 61
5 Empirical Findings and Analysis ................................................................. 63
5.1 Institutions ......................................................................................... 63
  5.1.1 Centrally Planned Rigid System and the MINCEX ......................... 63
  5.1.2 The FDI Sector ............................................................................... 66
  5.1.3 Economic Freedom ........................................................................ 75
  5.1.4 Special Economic Free trade zones ............................................... 84
  5.1.5 The Embargo ................................................................................ 86
5.2 Formal/informal rules and norms .......................................................... 91
  5.2.1 Decree law 77 of 1995 - 2014 ......................................................... 91
  5.2.2 Decree law 118 of 2014: same law, new wrapping ...................... 98
5.3 Discussing FDI .................................................................................. 100
  5.3.1 Credible Commitment .................................................................. 106
  5.3.2 Foreign Frustration ....................................................................... 109
  5.3.3 Concluding FDI ............................................................................ 110
6 Conclusion: signs of change signs of continuity ......................................... 112
Literature ................................................................................................... 115
Appendix .................................................................................................... 118

Tables and Figures

Figure 1: GDP growth (%) according to World Bank expectations .................... 4
Figure 2: Factors affecting C.C and FDI ....................................................... 20
Figure 3: Research Design ....................................................................... 40
Figure 4: Number of FDI in different types of businesses ............................... 70
Figure 5: Evolution of dissolved International Economic Associations ................ 71
Figure 6: Number of total IEAs in Cuba 1990-2009 ....................................... 72
Figure 7: Annual FDI in Cuba, 1993-2011 .................................................... 73
Figure 8: Annual FDI in D.R, 1993-2011 ..................................................... 74
Figure 9: 2015 Score Comparisons .............................................................. 76
Figure 10: FDI per Sector 2013 ................................................................. 77
Figure 11: Businesses with FDI modalities 2013 ........................................... 78
Figure 12: Elements considered important for investment environment by EU investors .... 79
Figure 13: Property freedom comparison .................................................... 81
Figure 14: Freedom from corruption comparison ......................................... 83

Table 1: Factors to be considered ................................................................... 35
Table 2: Monthly employment cost of Cuban workers in FDI companies (1995) ........ 97
**List of Abbreviations**

AECEs – Asociaciones Económicas con Capital Extranjero
ALBA - Alianza Bolivariana para los Pueblos de Nuestra América
APPRI - Acuerdos Bilaterales para la Promoción y Protección Recíproca de Inversiones
BIT – Bilateral Investment Treaty
CCP – the Cuban Communist Party
CEEDC – Centro de Estudios de la Economía Cubana de la Universidad de La Habana
COMECON- the Foreign Trade Authority for the U.S.S.R and East Europe
D.R. – The Dominican Republic
FCSC – Federal Settlement Commission
FDI – Foreign Direct Investment
FICI – Foreign Direct Investment Confidence Index
GATS - General Agreement on Trade in Services
GDP – Gross Domestic Product
ICSID- International Centre for the Settlement of Investment Disputes
IMF – International Monetary Fund
LDC – Less Democratic Countries
MINCEX - Ministerio del Comercio Exterior y la Inversión Extranjera
MINVEC - Ministerio para la Inversión Extranjera y la Colaboración Económica de Cuba
MNE – Multinational Enterprises
OECD - Organization for Economic Cooperation and Development.
R&D – Research and Development
TRIPS – The Agreement on Trade-Related Aspects of Intellectual Property Rights
U.S - United States
USA – The United States of America
WB- World Bank
WTO – World Trade Organization
ZEDM – Zona Especial de Desarrollo Mariel
1 Introduction

This is a case-study of Cuba, a Communist state that has not had FDI (except Soviet subsidies and trade with COMECON) in their economy since the revolutionary takeover in 1959, and the expropriation of foreign properties the first years of the revolution. In this thesis I claim that the fall of the Soviet bloc led to a reorientation of Cuban policies and economy, without any real and profound changes being made. Since the initialization of normalizing the diplomatic ties between the U.S. and Cuba, there have been many debates on the path Cuba may take economically as well as politically. Cuba is especially focusing on attracting FDI as a strategy to develop their economy. FDI is considered both from capitalist countries, and communist states as Vietnam and China, as a valid development strategy. It is relevant both from a classical neoliberal view, and in the modernization of single party states that are ideologically close to Cuba. FDI as a development strategy is applied to generate “spillovers” that will develop economy, technology and society. We will look closer on how this takes place in the theory part of this thesis.

Though FDI is attracted, it does not necessarily mean it will generate the spillovers that the host nation is hoping for. This could be the result of external or internal factors, and I will especially be focusing on the internal factors of the Cuban case. To attract investors, there needs to be a friendly investment environment that secures the investor market access, transfer of profit and expansion possibilities. For this to happen, investors need safety through law, strong and safe institutions, and a certain degree of credible commitment to international law and practices, to ensure the investors that their investments are safe. Through the thesis, I will establish what the signs of continuity are, and what the sings of change are in the Cuban institutional framework. These signs can help to prove the validity of Cuba´s reforms and level of credible commitment. Also, this study helps to localize some of the obstacles investors face as they invest in Cuba, and how these obstacles affects the inflow of FDI to the island.

Despite substantial reforms initiated since Raúl Castro´s takeover in 2006, Cuba has failed to encourage more foreign investment into the country´s crippling economy, and is now putting the goal of sustainable growth in danger unless extensive and profound changes are made. The market-oriented reforms that have taken place since 2007, with its Soviet-style political system, are supposed to make the investment environment friendlier, but investors have still been cautious and hesitating. Cuba needs to sustain a higher rate of investment to
close the gap where Cuba only have had an annual investment of just 13% in recent years compared with an average of 23% in the rest of Latin America and the Caribbean. Cuba’s rhetoric towards FDI has changed, and many countries such as China, Russia, Brazil, Singapore and various EU members have expressed interest in investing, despite the U.S. trade embargo. However, many obstacles still remain.

In this thesis I address the obstacles that investors face when Cuba, as a communist state with a static economic system, introduce a capitalist tool as FDI to accumulate capital. The literature on FDI, (effects, dynamics and results) is vast and must be understood in the context of the investment one seeks to analyze. It is difficult generalizing on the basis of whole countries that use FDI as a development strategy. A number of scholars have elaborated on the subject, but I wish only to give an introduction to the subject, which clarifies what theories developing countries rely on when they adapt and transform policy to attract FDI. As we will see in the theory, even though different countries experience different results with FDI, and the literature on the theme is vast, some general trends can be observed.

Since Fidel Castro transferred power to his younger brother Raul Castro in August 2006,1 we have observed some trends of reformation in the rigid regime of Cuban policies and bureaucracy. Are they really profound transformations in the Cuban system? Or do these transformations exist solely to make Cuba appear more lucrative to foreign investors at the international arena? We especially observe economic reforms and measures taken to enhance economic growth through initiatives as the “Puerto Mariel”,2 and the new decree law 118 of 2014, which seek to enhance the flows of inward FDI through improving the environment for investors. Still, while the transformations appear to be genuine and real, we observe little mobility for domestic private actors and long and bureaucratic approval periods for foreign investors. The Cuban government has been accused of caring more about retaining power than to improve economy.3 They are committed to the ideas of José Martí, the stand against capitalism and the social political stands of Marx, Engels and Lenin (which is firmly constituted in the Cuban constitution),4

I address this “in between state” where Cuba are right now, between simultaneously trying to maintain and liberalize a highly ideological political and economic system. Talks with the US about normalization of their relationship, and the reopening of embassies, can very well be the security investors need to invest in the Cuban economy. These last events will require the Cuban government to show commitment on a whole different level than ever before, as this is the first time the US takes a “bottom-up model of change” approach to Cuba since the collapse of the Soviet Block.

This thesis relevance should be considered in the light of recent events on Cuba, and a contribution to the research on Cuban economy and future perspectives for the island.

1.1 Background: FDI in Cuba

When Fidel Castro triumphed in Havana in 1959, he had no clear political or economic policy or reforms. The object was to achieve a change within the distribution of wealth and the existing benefits, and education, health services and nutrition to the people. The social revolution was realized by Soviet military protection and economic aid, as they in 1960 entered an economic and ideological cooperation where Soviet subsidized the Cuban socialism.\(^5\) Some trends became clear within Castro’s second year in power: the nationalization of the economy, a sharp turn towards the Soviet bloc, the establishment of an authoritarian regime, and the start of an egalitarian social economic policy.\(^6\) Foreign direct investment was considered an imperialistic repressive means to extract resources and wealth from their “colonies”. The foreign owned properties were expropriated, and FDI was kept out of Cuban economy the next three decades.

The last 20 years, Cuba has embraced some degree of transformation in the system of law and the economy in order to adapt to the world economy. At the same time their economy has been under an embargo from the only superpower in the world, the U.S.A. This has been an external factor with significant effect on the Cuban economy, and will be addressed properly later in my thesis. FDI is one of the few sources of foreign capital available to Cuba, as aid from foreign governments and international organizations is virtually non-existing.\(^7\)

\(^6\) Ibid. P. 311
1.2 Defining the Case

“Minister of Foreign investment and Trade” Rodrigo M. Diaz stated that the economy needs to grow at around 7 percent per year, and 25-30 % of that needs to be used for investment. However, numbers from the World Bank (WB) suggest a less ideal result and a more pessimistic future, as seen in figure 1. We observe that (“the miracle of”) China is the only country with this kind of growth the last decade (some African states have also had high growth rates, but they are initiating reforms from a different level of development, which makes the growth rate artificially high as investments takes place). Still, statistics and future result, especially in closed countries as Cuba, are difficult to foresee as the predictability of such countries is not tied up to a democratic system of rules and laws. The World Development Indicators of the World Bank are probably the most current and accurate global development data available concerning national, regional and global estimates.

![Figure 1: GDP growth (%) according to World Bank expectations](image)

Source: The World Bank Global Economic Prospects

The most important means within the control of the Cuban government, trying to obtain such growth rates, and foreign capital, is FDI. Even though Cuba firmly adheres to its socialist political and economic framework, the government has taken a series of measures to promote FDI in the country. Since the disappearing of the socialist bloc and the economic crisis that

---

followed, representatives of the Cuban government have frequently expressed the national interest in attracting foreign capital to boost the economy. New laws concerning FDI were passed in 1995 and 2014, special economic development free zones were created, and former ties to the EU and U.S reopened.

Since Raul Castro came to power in 2006, several reforms have been initiated to facilitate economic activities and to release some pressure on restriction on civil society. Still, Cuba struggles with its credibility, which affects inward flow of FDI significantly. For investors, it is questionable if the reforms are as “deep” as they formally appear through written laws. Also, the economic experimentation happens within free zones where the “normal Cuban” is held outside of participation. The experimentation with market economy, and the opening of “all” sectors to FDI, seems to be favored only as a possible way to finance the existing political and economic socialist model.

Cuba is a communist state, which gives the country a level of “short term” predictability as all power rests within the party. This creates uncertainties for investors, as there are no independent juridical bodies to control power, or condemn it if needed. In addition, the process of approving investor prospects is long and bureaucratic, which all affect the rate of “credible commitment” the country enjoys.

1.3 Objective and Research Questions

Academics and politicians frequently present “opportunities”, “future perspectives”, “past (own) experiences”, and comparative suggestions of other communist states that have made a transformation towards a more open economy, while still withholding a communist political system with centralized power structures. However, Cuba demands an understanding of their cultural, historical, political and economic context. The Cuban state spends a lot of time and consideration of every reform and decision they make, to make sure it complies with the socialist agenda. That is, not letting go of fundamental principles of the Cuban socialism at the same time as they wish to “renew”, “develop” and “fortify” this political direction. It is a long, slow and careful process, which many thought would accelerate considerably as communication with the US reemerged on December 17, 2014, but the results are still minor. On the other hand, some political and economic transformations that have begun would be hard to retract without creating social disapproval amongst the people. However, large

---

10 Mesa-Lago, Cuba En La Era De Raúl Castro: Reformas Económico-Sociales Y Sus Efectos.
transformations need real institutional change, which is an even longer process that I will address later in my thesis.

The objective of this case-study is to investigate some of the main institutions handling FDI, and the formal/informal rules and norms of which the institutions consist. Further, I investigate how these formal/informal rules and norms affect Cuba’s level of credible commitment, which also affects the country’s inward flow of FDI. Based on the theoretical framework in chapter 2, these are the questions that appeared most relevant, and will be the guide for my study of Cuba:

1. Why does Cuba want FDI as a development model, and how does FDI provide Cuba with the proper spillovers? How do formal/informal norms and rules of the Cuban institutions affect the country’s credible commitment and FDI?
2. Have the obstacles been the laws, or the execution of the laws?
3. What are the Cuban political, economic and cultural contextual experiences, and how do they affect credible commitment and FDI?

Due to the limitations of a master thesis there are several laws and elements I have left out. I choose to focus on elements that I mean have the greatest impact on credible commitment and inflow currents of FDI.

1.4 Overview of the Thesis

In this first chapter I have given a brief introduction to what this thesis will be about. In chapter 2, I will go through standard theoretical presumptions about “FDI”, “Institutions” and “Credible Commitment” referencing to authors commonly recognized as well embedded in the respective theories. Figure 2 in the theory section will be a guide to the construction of this thesis, whereas table 1 will give us an overview of the elements investigated in this case-study.

In chapter 3, I present the methodology of this thesis. I explain what is beneficial with a case-study based on limitations, possibilities, and theoretical framework. I use some general theory of case-study research, but instead of focusing on the general theory, I specify what is good, and not so good, with my case-study.

Chapter 4 gives a contextual background with special emphasis on economic history and how it affects credible commitment and FDI. This chapter presents the formation of Cuba’s institutional framework through its economic, societal, and cultural history from the
beginning of the revolution until today. I use the political cycles of Mesa-Lago as a framework to the historical context, because the “cycle-framework” generates a better understanding of complicated history, and illustrates the inconsistency of Cuban policy.

In chapter 5, I analyze the empirical material and data of this thesis with chapter 4 as a contextual base. I present institutions, rules and norms, and how they affect credible commitment and FDI, which again explain why Cuba has had little or no success with this capitalist strategy for development. In the last part of this chapter I discuss, based on the analysis and my findings, how Cuba’s credible commitment and inflows of FDI are affected by formal and informal rules and norms, which leads me to the conclusion in chapter 6.
2 Theoretical Framework

2.1 FDI

In this chapter I will present a theoretical framework for the thesis. In the first section of theory I will present the most important features of FDI for host economies. The literature on actual functions of FDI is vast and contradictory, but I will present the most common understanding of theory concerning benefits, and an adequate critique of how host countries focus on policies towards FDI. Second, I address conditions that need to be in place for FDI to work, by presenting theory of credible commitment and institutions and some elements relating to these factors.

2.1.1 Authors and relevance.

I will mainly use Theodore H. Moran, Edward M. Graham and Magnus Blomström and their extensive volume of new (2005) research on FDI and host-country economic performance in “Does Foreign Direct Investment Promote Development?”11 Several investigators contribute to this research, and their research is presented in their separate chapters. The book addresses themes important to understand as we explore the Cuban case; as the impact of inward FDI on host countries, FDI and externalities, FDI and local economic development, Multinational Companies (MNC) and backward linkages, how FDI affect host country development and other important topics. I will not explore or elaborate on the different topics in detail, as they all are extensive case-studies, but instead present the general understanding of what FDI is, how it works, and why states wish to avail themselves of FDI as a development strategy.

I will also use some theoretical framework of Giorgio Navaretti, Anthony Venables and Frank Barry, who present a comprehensive analysis of the economics of multinational enterprises. I include their work in the theory chapter to enhance the theoretical findings. They thoroughly assess what they are, why they exist, and what their economic impact on home and host countries is.12 Also, Elisabeth Grøvan Ruud preferred Navaretti, Venables and Barry in her master thesis on;

In her thesis she gives a presentation of the theoretical and empirical foundation of bilateral investment treaties (BITs) and FDI. As a secondary source her findings are relevant to the degree it verifies, or contradicts, the general perceptions on FDI that I present by Moran, Graham and Blomström, but mostly I used it as a guide to other relevant primary sources.

Furthermore, I found Sanjaya Lalls working paper on “FDI and Development: Policy and Research Issues in the Emerging Context”, beneficial to use. Some of the more important subjects Lall address deals with the benefits and costs of FDI to development, and the market failures that affect their impact on developing host countries. It focuses on the impact of FDI on local enterprise development, static versus dynamic benefits and bargaining with Multinational Enterprises (MNEs). I use Lall, not only because his findings are compatible with the other theory applied, but because his work is of good quality and is easy to comprehend. His working paper sums up the main points of the other authors as well, in a comprehensive and efficient manner.

In order to address institutions and credible commitment, I mainly use Peter North, who is a leading academic on the field. Most of the literature on institutional theory I found referred to North as main source. To make practical use of the theory I also introduce J.P. Singh who measures the degree of credibility and liberalization.

2.1.2 Functionalities of FDI

Addressing FDI, I use the definition of “Advocates for international development” in their legal guide on “Governing Foreign Direct Investment in Host Countries”, as it covers the term extensively.

“Foreign investment can be generally understood as the transfer of capital to a country, commonly referred to as the host country, by a non-resident entity. FDI is one form of foreign investment characterized by a certain degree of influence and control over assets in the host country. It is distinguished from the provision of cross-border bank loans and portfolio investment (where there is no active involvement in the management of the enterprise, for example, shareholdings in the host country’s companies through managed funds”).

---

However, there is no detailed, authoritative and universal legal definition of what constitutes direct investment. The sufficient degree of control and influence varies in scope depending on applicable law in a particular jurisdiction, and some jurisdictions do not make distinctions between different forms of foreign investment. Therefore, when dealing with a particular legal regime governing FDI, it is important to check how FDI is defined. The Organization for Economic Co-operation and Development (OECD) has recognized the need to agree a standardized definition of FDI for the purposes of compiling statistics, and has produced its own Benchmark Definition of FDI to which the International Monetary Fund (IMF) refers in its Balance of Payments Manual. The OECD’s Benchmark Definition states that:

“…a key characteristic of FDI is the presence of a 'lasting interest' in an enterprise, consisting of a 'long-term relationship' and a 'significant degree of influence', and considers ownership of at least 10% of the voting power to be evidence of such influence.”\(^{16}\)

As mentioned in the definition, there is no detailed, authoritative and universal legal definition of what constitutes direct investment. One has to explore the definition of the term within the host nation in which one wants to invest. Most nations will be close up to the above mentioned definition where the basic is a foreign investor, state or private actor, that wish to penetrate a host nation’s local market and economy. It can also be the other way around, a host nation seeking state or private actors to invest in their local market and economy.

However, advocates for international development also mentions four methods of making FDI:

- the creation of a new subsidiary and/or manufacturing base in the host country (often referred to as ‘greenfield FDI’);
- mergers and the acquisition of existing businesses in the host country;
- participation in joint ventures; or
- Re-investment of profits into projects in the host country.\(^{17}\)

Among the four methods of making FDI, I will especially be addressing “joint ventures” later in this thesis as it is the preferred choice of method by the Cuban government.

\(^{16}\) Ibid. P. 3
\(^{17}\) Ibid. P. 3
In the relationship between FDI and host nations, my focus will be on the internal environment of the host nation rather than the foreign investor. I will not direct an extensive amount of attention towards theory of capitalism and extraction of capital and resources, social corporate responsibilities etc. This thesis addresses the Cuban case and internal factors that affects inflow currents of FDI.

2.1.3 Spillovers

FDI has various effects on host economies. Navaretti and Venables divide the effects, which are transmitted through different channels, into three groups: (a) “product market effects”, where a FDI project may cause the firm to change the quantities of goods that it buys and sells in the host and home country market. If a MNE enters by merging or acquiring an existing supplier, the effect may be anti-competitive, harming consumers, but it may also increase competition in the market, and perhaps also variety or quality, which tends to raise consumer welfare. If the MNE has higher productivity than local firms, then some of the benefits may be passed on as a price reduction. (b) “Factor market effects”, which can arise in both capital and labor markets. There is general capital inflow, augmenting local supplies of capital, but the more important impacts are in labor markets. The questions are as follows; how does it affect the overall demand of labor, and if the MNEs raise employment? Does outward investment by FDI reduce the demand for labor? Does the presence of MNEs raise the demand for skills in host economies? Does the expansion of activities abroad raise the demand for skills in host economies? Does the expansion of activities abroad raise the demand for skills at home, and what happens to factor prices? The last group is (c) spillover effects which are arguably the most important benefits to accrue from FDI. The importance of these effects depends on the form of the investment, whether it is horizontal or vertical, and the characteristics of the countries. In this chapter, I will elaborate further on the latter group (spillovers). A further explanation of product market effects is of less relevance for my thesis, and will to some degree be covered through the theory. The labor paradigm within the factor market effects is an important element that I elaborate in chapter 5.

The “spillover” effect is crucial for host economies when they seek to attract FDI. “Spillovers” is the term used to describe the benefits host economies aim to take advantage of as a FDI enters and develop in the economy. Host nations do not only seek to gain access to

---

18 Navaretti, Venables, and Barry, *Multinational Firms in the World Economy*. P. 40
foreign capital, but also to develop industry and to acquire “know how” on technology and management (amongst others). The desire is that knowledge and know-how “spills over” on the host country economy in the forms of technology, salary, competition, productivity, competence etc.\textsuperscript{19} The spillovers from FDI occur as MNE enters and increases the productivity of local firms in a host nation. The spillovers can occur as local firms improve efficiency through absorbing technology and market strategies from the foreign firm. This can be done by observing or hiring employees who have worked for the MNEs. Another form of spillover occur when the existence of a MNE creates greater competition on the local market, and in that way forces the local firm to use their existing resources in a more efficient way, or to search for new technology.\textsuperscript{20}

What happens if there are local firms in the same sector, and how can they survive/adapt to the competition? If a foreign and a local firm compete in the same sector, the foreign firm will have no reason to share technology or know how through spillover. They may protect themselves through a formal protection of intellectual property, paying higher wages to the employees so they will not leave to competitors, or by just establishing themselves in host nations where the knowledge and production level are so weak that there is no real competition. Still, MNEs have positive influence on local firms that function as suppliers in “downstream” industries, but no effect on competing firms in the same sector. The downstream industries can enjoy spillovers as they provide the foreign firm with some parts or services necessary for their line of production. It is beneficial for the foreign firm as well that a supplier is effective in both their management production and economy. This gives a foreign firm the incentives to share know how and technology with the supplier in order to make their production more effective. In the end, the foreign firm will profit by sharing know-how, management and technology by making their supplier more cost efficient.

As mentioned before, the results vary, and there is vast literature on FDI and its function in host economies. I will not elaborate on the function of each spillover effect as it would require a proper case study to address each spillover actual effect on host economy. However, I will scratch the surface of some of the more important spillovers.

According to Lall, the host country can induce the spillovers and transfer their advantages in appropriate forms:

\textsuperscript{19} Moran, Graham, and Blomström, \textit{Does Foreign Direct Investment Promote Development?} P. 46
\textsuperscript{20} Ibid. P. 47
• Capital: FDI brings in investible financial resources to capital scarce countries. Compared to commercial debt or portfolio investment, the inflows are more stable and easier to service. TNCs invest in long-term projects, taking risks and repatriating profits only when the projects yield returns, in comparison to other sources of capital.

• Technology: Developing countries lack the proper technology to efficiently produce goods and compete on the international market. The technology is often outdated, even in mature industries. The efficiency they operate with, compared with the technologies they use, is often relatively low. However, part of their productivity gap is compensated for by lower wages and technical inefficiency. Also, obsolescence affects the quality of their products and handicaps their ability to cope with new market demands. TNCs bring modern technologies not available without FDI, and raise efficiency in the use of technology. The foreign firm may adapt technologies to local conditions, drawing on their experience, and in some cases set up R&D facilities. The foreign investment can stimulate efficiency in local firms, both suppliers and competitors, by providing assistance, acting as role models and intensifying competition.

• Skills and management: The advanced skills possessed by TNCs, MNEs and foreign firms can be transferred to host countries by bringing in experts and by setting up training facilities. They also possess new management techniques of top quality, whose transfer to host countries offer enormous competitive benefits. As local firms and affiliates are integrated into foreign firm networks, they can develop capabilities to service the regional or global system in specific tasks or products as new markets opens.

• Market access: TNCs can provide access to export markets, both for existing activities and for new activities. They are by definition the only way to enter the international production systems that increasingly dominate trade in sophisticated and high-tech products. There are also many important benefits in export activity such as: technical information, realization of scale economies, competitive stimulus and market intelligence.
• Environment: TNCs often possess environmental technologies that can be used in all countries in which they operate.\(^\text{21}\)

Spillovers in form of increased salaries show that most of the foreign companies pay a higher wage than local firms, in both developed and developing countries. Also in those cases of a foreign takeover of a domestically owned firm, the salaries rose. In the opposite case, where a foreign owned firm experiences a takeover from a domestic firm, it showed the opposite effect on wages. This illustrates that foreign takeovers produce wage increases. Still, the effect of wage-spillovers is not exclusively positive. Mexico and Venezuela showed negative effect on foreign firm spillovers in form of wages. There are several plausible explanations, but restrictive labor market conditions seemed imperative to the outcome. An “employment laws index” produced by the World Bank, showed that Mexico and Venezuela were ranked among the most restrictive countries when it came to legislation on employment and dismissal of labor.\(^\text{22}\) A highly protected market and a locally owned sector can be inefficient and lacking entrepreneurship, which makes it difficult for local firms to compete with foreign investments that may have received incentives from the host nation to produce in their economy.\(^\text{23}\)

As I will elaborate later in this thesis, the Cuban institutions which manage employment, and the legislation concerning it, are both restrictive and bureaucratic.

2.1.4 Does FDI work?

Here I address some theories concerning to what degree FDI actually provides the spillovers it promises. FDI is considered by most developing countries as a vital resource for development. Still, the economic effects of FDI are very difficult to measure accurately. The econometric analysis of FDI and development is of long standing, but its conclusions remain unclear. While some analyses show a positive impact, others remain agnostic. Growth depends on many factors whose effects are difficult to disentangle, and since FDI itself affects several of these factors, an agnostic conclusion is probably the most sensible according to Lall.\(^\text{24}\)

\(^\text{21}\) Lall, "Fdi and Development: Policy and Research Issues in the Emerging Context." P. 7-8
\(^\text{22}\) Moran, Graham, and Blomström, Does Foreign Direct Investment Promote Development? P. 26-28
\(^\text{23}\) Ibid. Å. 40
\(^\text{24}\) Lall, "Fdi and Development: Policy and Research Issues in the Emerging Context." P. 5
“Multinational enterprises have encountered hostility and resentment in all countries that host substantial foreign investment, but nowhere more than in less democratic countries (LDCs, or as in the Cuban case, a non-democratic country), where they get blamed for the national economy’s manifest shortcomings, not to mention that historical sins of colonial domination. Economic analysis has played no great part in resolving disputes between critics and defenders of the MNE’s (FDI) role in development processes. There is little consensus on what institutions and policies most effectively promote the goal of economic development…”

The quote has relevance to our Cuban case, as the governmental suspicion towards foreign activity on the island is one of the major obstacles. Still, in the last 20-25 years the attitude towards FDI has changed, not only in the development literature, but also in the part of the national governments traditionally strongly hostile to MNEs and FDI. The appreciation of the nature and advantages of FDI in host countries rose, as some developing countries had exceptionally successful rates of development drawing heavily on FDI. Many regimes restrictive to FDI had to rethink their role as FDI appeared to lead to a higher income of capital, and host developing countries improved their capabilities to deal with FDI. The more advanced ones showed capability to absorb leading-edge technology transferred by the foreign investment, and to attract research and development (R&D) facilities. The value of manufactured products grew much faster than the value of unprocessed primary products. High-tech exports were the fastest growing group and resource-based products the slowest, and in high-tech exports, MNEs played the dominant role in most countries.

These developments occurred and coincided with growing liberalization of trade and a more general reduction in the role of the state in economic activity. Liberalization removed many inefficient and uneconomic interventions, but in some cases, the shift to market forces may have been carried too far, and possible deficiencies in free markets were ignored. The neoliberal approach (the Washington Consensus) led many governments not only to remove all restraints to FDI flows, but also to abrogate tools to attract, target, guide and bargain with the investors. The objectives of a foreign investor can differ from those of host governments, as governments might seek to spur development, while the investor wish to enhance their profitability and competitiveness.

Even though the results of FDI are unclear, the presence of a foreign actor with superior knowledge and technology brings something to the host economy; it is necessary and imperative, on the part of host countries, to improve national competitiveness. That means the ability of the economy to sustain income growth in an open setting. Growth can be sustained only if countries can create new, higher value-added activities that hold their own in free

---

25 Ibid. P. 2
26 Ibid. P. 2
markets. It requires a lot, but the ability to use new technologies efficiently and furnishing the requisite skills and strong institutions, are central to the host nations. A certain level of economic freedom is also crucial to appear attractive and committed to the investment. Lall addresses an issue that would appear to be of importance for host nations such as Cuba, especially the second set of market failure, namely that:

“Policies on FDI are needed to counter two sets of market failures. The first arises from information or coordination failures in the investment process, which can lead a country to attract insufficient FDI or the wrong quality of FDI. The second arises from divergences between the private interests of investors and the economic interests of the host country. This can lead FDI to have negative effects on development, or to positive but static benefits. Private and social interests may of course diverge for any investment, local or foreign. However, some divergences are specific to foreign investment. FDI differs from local investment in that the locus of decision-making and sources of competitiveness in the former lie abroad. The foreign investor has less commitment to the host economy and is also more mobile. Many governments feel that foreign ownership has to be controlled on non-economic grounds, for instance, to keep cultural or strategic activities in national hands.”

Cuba has been very cautious in regards to who they allow to invest, and within which sector. Many would call Cuba paranoid when it comes to conspiracy theories about espionage, and Cuba has arrested foreign businessmen accusing them for bribery and other charges which severely hurt their level of credible commitment. I will return to this matter in the analysis.

What Moran et.al, recognizes is that where FDI can operate within an open framework for trade and investment, it positively affects the economy and the development of the host country. FDI in an environment where local affiliates produce for the domestic market behind trade barriers, with joint ventures and strict rules and laws for the foreign investors, has had a much less positive impact on host economy and welfare. Our Cuban case would be placed under the latter strategy; we will return to this subject as we treat the laws on FDI from 1995 and 2014.

Although we have established some of the positive effects of FDI, they do not automatically provide spillovers and benefits to host economies without the creation of a proper environment for absorption. If the environment is not in proper condition, the countries may have to choose between investments that offer short as opposed to long term benefits; the former may lead to static gains but not necessarily to dynamic ones. Cuba appears unprecise about what gains they really want from FDI.

27 Ibid. P. 3
28 Ibid. P. 6
29 Daniel Trotta, "Cuba Frees Canadian Businessman Tokmakjian after Three Years in Jail," Reuters 2015.
30 Moran, Graham, and Blomström, Does Foreign Direct Investment Promote Development? P. 24
A large inflow of FDI can add to foreign exchange and investment resources in the host economy, but it may also lead to a crowding out of local firms or create exchange rate problems. If the government wants to generate employment, they might favor labor-intensive, low technology investment, and if they were to promote technology development it would favor more sophisticated investors. There are many “trade-offs”, and there is no universal answer to how they should be made; there is, so far, no ideal policy on FDI that applies to all countries at all times.\textsuperscript{31}

The most attractive immobile assets for export-oriented foreign investors are primary resources, good infrastructure, skilled and productive labor, and a line of efficient suppliers, competitors, support-institutions and services. Cheap unskilled labor still remains a source of competitive advantage, but its importance is diminishing, and it is not a base for sustainable growth since rising incomes erode the edge it provides, which has been the case in China lately. Natural resources are similar: they provide a rent as long as the particular commodities are in demand, but without upgrading technologies or setting up downstream industries, they may suffer of stagnant prices or substitution. However, attracting FDIs mobile assets requires host countries to improve the quality of their immobile assets and create an unhostile investment environment.\textsuperscript{32} What is relevant for our case is the general understanding of why host countries choose FDI as a development strategy when they look at the existing research on theories and functionalities of FDI. Also, which requirements need to be fulfilled to create an attractive investment environment in the host economy, is of interest.

In the globalized world, developing countries wish to appear as suitable host nations, with a favorable environment for investment, to international actors. The A.T. Kearny Foreign Direct Investment Confidence Index (FICI) was established in 1998. The FICI ranks the top countries for FDI based on how changes in their political, economic, and regulatory systems are likely to affect foreign direct investment inflows in the coming years. To be a part of this list creates credibility through reputation, as well as confidence, as the FICI is considered a trustworthy index by investors.\textsuperscript{33}

Dani Rodrik, on the other hand, criticizes this system where states consider FDI as the ultimate yardstick for evaluating government action, and seek to enter such indexes as mentioned above. It should not be necessary to appeal to “investor sentiment” or

\textsuperscript{31} Lall, "Fdi and Development: Policy and Research Issues in the Emerging Context." P. 9
\textsuperscript{32} Ibid. P. 4-5
“competitiveness in world markets” to get policy maker’s attention. He criticizes the universal understanding of trade and investment policies as the surest way to achieve economic growth and poverty alleviation, as insertion in the world economy is more complicated than just removing trade and investment barriers. Countries also have to comply with a long list of admission requirements, and comprehensive institutional reforms, supposedly to maximize the gains and minimize the risks of participation in the world economy. Global integration has become, for all practical purposes, a substitute for a development strategy.

Rodrik says that complying with the first order of business diverts human resources, administrative capabilities, and political capital away from more urgent development priorities as education, public health, industrial capacity, and social cohesion. It will undermine democratic institutions by removing the choice of development strategy from the public debate. Bilateral and regional trade agreements impose tight prerequisites on developing countries in return for crumbs of enhanced “market access” in the larger partners.

The institutional reforms needed to join the international economic community are expensive and preclude investments in other crucial areas, but supposedly these costs will be more than compensated by the cash increases in economic growth results from insertion into the global marketplace. The East Asian tigers or China have often been used as an example of what FDI and trade can achieve, but in these countries, trade liberalization was a gradual process over a period of decades rather than years. They combined their outward orientation with high levels of tariff and non-tariff barriers, public ownership of large segments of banking and industry, export subsidies, domestic-content requirements, import-export linkages, patent and copyright infringements, directed credit and restrictions on capital flow. Such policies are precluded by today´s trade rules, or are frowned upon by IMF and the World Bank. It was not until after there had been a transition to high growth that significant import liberalization took place. Few of the national success stories of economic growth are taken from the “Washington Consensus” economic policies. Development strategies need to be tailored to prevailing domestic institutional strengths, according to Rodrik.

35 Ibid. 7-8
“Policy makers that look to Washington and financial markets for the answers are condemning themselves to mimicking the conventional wisdom du jour, and eventual disillusionment.”

However, what is economically wise for states opening their economy is not the same as what is needed to appear attractive to foreign investors. Given that states have decided to attract FDI, and wants to appear as attractive host nations on the international market, the theory states that it is important that host nations establish legislation favorable for investments that comply with international agreements like those of the World Trade Organization (WTO) and BITs. Also, investors require a labor force, location, access to market, tariff barriers, respect for international agreements on trade as “The Agreement on Trade-Related Aspects of Intellectual Property Rights” (TRIPS), personal security, possibility of expansion, political stability, competitiveness, financial regime and system, conditions for export and import, authorization processes, establishment costs, law, property rights, and more as they seek to invest. These requirements add up to the degree of “credible commitment” a host country has on the international arena. Credible commitment is the key term for attracting FDI. The term covers all the important factors that need to be in place in order to appear attractive to foreign investors. The level of credible commitment and inflow of FDI are again affected by the host country’s institutional framework. I will return to the concept of “credible commitment” and institutions in the next sections of the theory chapter.

The factors affecting investor choice of location relate to efficiency and competitiveness. The sites that will receive most FDI are those that allow foreign companies to set up facilities able to withstand global competition. The host country has to provide competitive immobile assets through skills, infrastructure, services, supply networks and institutions, to complement the mobile assets (financial capital, skilled workers, household with external incomes) of foreign companies. Large markets will continue to attract more investment than small ones due to transport costs and taste differences, and few countries can afford to take a continued inflow of FDI (especially high quality, export oriented FDI) for granted. Lall says it well:

36 Ibid. P. 13
“This means that the ultimate draw for FDI is the economic base of the host country: just offering incentives for investors cannot compensate for the lack of such a base.”

Let us keep Lall in mind as we in chapter 5 address the economic base of Cuba and the FDI sector.

2.2 **Conditions for FDI to work.**

In this section, I will address which conditions need to be in place for flows of FDI to occur and function. There is an existing debate of what kinds of conditions are needed, and there are many conditions to consider. Central to these conditions is the term credible commitment, which again is affected by the institutional framework of a host nation. The institutional theories address the importance of the relationship between formal and informal rules and norms, state and economy, and society and cultural heritage.

![Diagram](image)

*Figure 2: Factors affecting C.C and FDI*

*Source: Own figure.*

---

38 Ibid. P. 9
In Figure 2 we have an overview of the conditions I will be addressing in this thesis and how the various factors affect each other. The state economy, policy, and the social and cultural heritage form the institutions which constitutes of different sets of formal/informal norms and rules. The norms and rules can create changes within the institutions, which may affect economy, policy, social and cultural behavior. All of them have an effect on the degree of credible commitment, which again affects the amount of FDI attracted. The other way around, FDI may also strengthen credible commitment through the inflow stream of “heavy” actors, giving the host nation credibility on the international arena.

2.2.1 Credible Commitment

What kind of “commitments” are we talking about when we relate the term with FDI? An investor that wishes to invest money into a state’s economy, or other another company, will need safety through legislation and strong institutions to be sure that the values that are invested are safe. Also, the possibility that future profits can be retracted or reinvested into the host economy’s markets.

Economies that have developed institutions, and can provide a high level of credible commitment, will enable more complex contracting. Throughout most of history and in much of the present world, institutions have not provided the credible commitment necessary for the development of low cost transactions in capital and other markets. There exists little evidence to support the view held by many economists, which is that the necessary institutions will be the automatic outcome of getting the prices right through elimination of price and exchange controls.\(^{39}\) What is interesting with North’s study is that it seeks to discover how institutions evolve through time, and why institutions that produce poor economic and political performance can persist. This should be interesting to apply on this case-study on FDI in Cuba.

The problem, according to North, is simple:

“How to bind the players to agreements across space and time?”\(^{40}\)

It is the informal norms that follow the formal rules that need to be revised. The existing literature concerning informal restrictions has focused on how these restrictions can

---

40 Ibid. P. 1
modify or enhance formal rules in both politics and economy. My understanding of North is reformation, or restructuring of the economy, without informal norms to support the formal norm changes, will not lead to a “deep” enough change. This again will not create the credible commitment a state seeks to build or improve. The strength of property rights, formal and informal rules, affects the degree of credible commitment a host nation appears with on the international market.

To achieve a satisfying degree of safety and to have low cost enforcement of contracts in international trade, you have to have a third party enforcement, which ultimately means polity or the state. You have to create a political system that will create rules and laws and enforce them at a low cost. What investors need is a certain level of credible commitment. This also applies for the host country seeking serious actors. It is a two-way relation. This is what makes it possible to have a successful impersonal exchange worldwide, with international organizations as WTO and the International Centre for the Settlement of Investment Disputes (ICSID) to monitor trade and punish those who do not follow the game. International law enforcement, though, will always be difficult when players are autonomous states. Those are also imperfect institutions trying to control a difficult situation of world trade and globalization.

Singh agrees with North’s perspectives, and mentions in his case study that “optimal credible commitment” entails rules or property rights that are impartial, transparent and legally binding. Rule of law, an independent judiciary, and an effective regulator are keys to ensuring that property rights meet all these conditions.

The degree of commitment represents the variation of FDI that exists in a country. Both domestic and international states can make commitments toward reformations. Most existing commitments at the international level often reflect domestic commitment level. One of the formal ways to conclude international commitments is through the framework elaborated by WTO, the “General Agreement on Trade in Services (GATS)”, at the Uruguay round in 1986-1994. Such commitments are important for investors looking for up-and-coming markets.

We see that creating and strengthening credible commitment and property rights is important when we want to explain variations in flows of FDI. International commitments are

41 Ibid. P 6
44 Ibid. P. 78
important because they make one country’s commitments transparent. The enforcement of commitment is contingent upon the domestic institutions. When domestic institutions can’t successfully realize the commitments, they will lose credibility. An international commitment alone will not be enough to attract FDI. The degree of divergence from the national liberalization program is reflected in the degree of variation of flows of FDI.\(^{45}\) Furthermore, Peter North emphasizes the time it takes to establish a credible reputation as crucial. Time is important for the investors since the uncertainty about the ruler’s behavior can only be diminished by the ruler establishing a reputation.\(^{46}\)

Low trust societies, which are struggling to realize the gains from trade and gains from innovation precisely because of the prevalence of predation, will have the most difficult time establishing credible commitments and signaling the content of that commitment in a way that solicits confidence that promises will be kept.\(^{47}\) In order to realize the great benefits of social corporations under the division of labor, credible commitments that bind the behavior of public officials must be established; this binding of government must be done in a way that signals to citizens that promises made will be kept. Also, in terms of the institutional design and with respect to the consistency with the underlying belief system in that society, the constitution being put in place must be self-sustaining.\(^{48}\)

### 2.2.2 Institutions

In this section, I will explore the meaning of the term institution, how it is applied and what is considered to be an institution. This is important for the thesis because the very essence of achieving successful reformations and absorption of FDI is, according to theory, the existence of strong institutions. I will mainly be using Douglass Cecil North’s discussion paper\(^{49}\), and article\(^{50}\) on institutions, Gretchen Helmke and Steven Levitsky book on “informal institutions and democracy” (partially building on North),\(^{51}\) and the case study of J.P Singh on “FDI

\(^{45}\) Ibid. P. 85
\(^{46}\) North, "Institutions and Credible Commitment." P. 9
\(^{48}\) Ibid. P. 50
\(^{49}\) North, "The Role of Institutions in Economic Development."
\(^{50}\) "Institutions and Credible Commitment."
variation in Emerging Markets”. I use the above mentioned works on institutions as I find them applicable to our case. North talks about two main issues:

“What makes dysfunctional economies or economies that do not work well, and what we can do about it”

The problem with institutional economics, and the reason it has faded from sight, is that it did not address explicitly the issues that had to be solved. According to North we have to understand what make economies work the way they do, which is a necessary precondition to say something about how we can make them work better. Therefore, I begin with a presentation of what institutions are, how they work, and why they work the way they do. Revising the whole institutional paradigm within politics, economics, society and cultural heritage would have given us a greater perspective on Cuba´s institutional framework, but this would demand a study of greater scale. I will address them in chapter 4 within the framework of “idealist and pragmatic cycles” of Mesa-Lago, with the perspective of how they affect the credible commitment and FDI.

Opening the market for FDI was one of the key points in the “Washington Consensus”, but North argues that neoclassical economics never was intended to deal with the issues of economic development. It evolved in the late nineteenth century and its objective was to explain efficient resource allocation in developed economies. It had two failures though,

1. It was frictionless;
2. It was timeless, static rather than dynamic in terms of its issues.

North´s presentation of institutions starts with some very basic assumptions, but gives us clear directions when we try to interpret and analyze our Cuban case. He says:

“Institutions would not exist in a frictionless world where there is no uncertainty. Institutions exist to reduce uncertainty in the world. In a world without institutions we would not know how to deal with each other. Institutions are the incentive system that structure human interaction. They can make predictable our dealings with each other every day in all kinds of forms and shapes. They thereby not only reduce uncertainty in the world but allow us to get on with everyday business and solve problems effectively. When we say institutions structure human interactions what we mean is that they provide incentives and disincentives for people to behave in certain ways; and if they are effective they structure and provide incentives and also structure economic, political and social activity. One cannot

---

52 Singh, “Fdi Credible Commitment.”
53 North, “The Role of Institutions in Economic Development.” P. 1
54 Ibid. P. 1
make sense out of the world with just economic reasoning. You have to know political and social theory and, as you are going to see, you must also know cognitive science.”

The reason one needs to know all of this is that we do not live only in an economic world, a political world or a social world, but in a world that consist in a mixture of all of them. The institutional theory should embody all of them and not only integrate various disciplines. It should also be able to integrate the analysis with those parts of neoclassical economic theory that are useful and helpful in solving problems. I will be addressing the formal and informal rules and norms that follow the various institutions to see how they affect Cuba’s credible commitment and flows of FDI.

Peter Boettke agrees with North’s presumptions, but elaborates on the notion of society and cultural heritage.

“This evolution of thought from prices to institutions to culture should not be interpreted as superseding what was learned during the earlier stage. But instead the stages should be viewed as the outgrowth of delving deeper into the original question of how to get an economy on track to provide generalized prosperity to the people within that economy. Generalized prosperity cannot be had without a private property market economy, but such an economy cannot be established on a wide scale without a system of governance bound by general rules and strict limits established on state action, and a country cannot meaningfully institute general rules and strict limits unless the informal beliefs and institutions of the people in question legitimate those rules and limits.”

The general lessons learned from the post-communist experience, is that we must see beliefs that legitimate the ends of governments; limits on the stakes of politics must be in place; property rights and personal rights must be defined; and credible and binding commitments to respect these rights must be established. The key to political order (according to North) is the establishment of credible bounds on the behavior of political officials. Private incentives may thwart economic progress by curtailing the progression from personal exchange networks to the extended order of impersonal exchange and realizing the gains from specialization, exchange, and social cooperation under the division of labor. To explain the wealth and poverty of nations, we must look towards the fundamental institutions of governance that “curb the predatory proclivities of man”. Also, a government strong enough to establish a constitution is almost by definition strong enough to break the constitutional

55 Ibid. P. 1
56 Boettke, “Institutional Transition and the Problem of Credible Commitment.” P. 46
57 North in ibid. P. 48
bindings any time it desires for political expediency. The tying of the rulers’ hands in politics appears to be more difficult than presumed, especially in autocracies and totalitarian states.58

2.2.3 Formal/informal norms and rules

In this section, I will look closer at the “formal” and “informal” sides of norms and rules. Helmke and Levitsky use the term “informal institutions” in their theory, which are socially shared rules, usually unwritten, that are created, communicated, and enforced outside officially sanctioned channels.59 Other authors would call for an own interpretation of informal institutions, but I understand them as informal norms and rules. Informal norms and rules are often enforced by actors and institutions within the state itself. I see institutions as a form of existing organization, office or equal, with formal and informal norms and rules that regulate and affect efficiency. Formal norms and rules are procedures that are created, communicated, and enforced through channels that are widely accepted as official.

The way actors perceive the issues that confront a society will shape the policies that they pursue. Surely, 70 years of communist policies should persuade economists that ideas matter and that there is no guarantee that the mental models, that models human construct to explain the world around them, will converge into a common denominator. Or that this denominator makes them develop a common interpretation implied by a rationality model. Surely, Fidel or Raúl Castro would benefit from a common set of ideas implemented through institutions within each sector of society. The interaction between the mental models that a society possesses, the institutional structure of formal/informal norms and rules, and consequent organizations, is the key to path dependence.60

The rulers must also signal specific content to the actors in the economy who have experienced public predation by the state far greater than the private predation the state was created to ward off. The citizens of the former Soviet Union had many times before heard that reforms were being introduced that would grant them more freedom in economic and political life, only to have those promises broken almost as soon as they were uttered. The relation between the citizens and the state was referred to as the “Big Lie”. To establish credible

58 Ibid. P. 49
60 North, “The Role of Institutions in Economic Development.” P. 18-22
bounds on their behavior, the rulers must do so in a manner that credibly signals to citizens (and investors) that they will keep their promise.61

In many contexts, informal rules and norms shape more strongly political behavior and outcomes than the formal, through bureaucratic and legislative norms of clientelism and patrimonialism. Scholars often fail to consider these informal rules of the game, thereby missing many of the most important incentives and constraints that underlie political behavior and economic outcomes.62

In our case, the Cuban way of doing things economically, politically and socially are central. North have a similar understanding of the terms; he thinks that in many ways the “informal norms” are more important than the “formal rules”. Institutions are made up of formal rules, informal constraints and their enforcement characteristics. Formal rules are those put into place as laws, constitutions and regulations, and have the character of being specific and defined precisely. Informal norms and constraints do not show up in formal terms, but may have a great effect on end results of formal legislations. They are ways of doing things, and the kind of formal rules that we have occupy a very small proportion of the guides to everyday behavior and actions compared to the informal.63

We observe that formal/informal institutional relationships are dynamic. Informal institutional elements often serve as a catalyst for change in the formal institutional elements. Formal rules may be created to entrench informal norms that actors find beneficial. The formal rules may also be modified to close loopholes exploited through informal norms. The informal elements may again lead to formal institutional collapse, by drawing public attention to the ineffectiveness of formal rules, and they may also contribute to formal institutional stability by enhancing the performance or increasing the benefits gained by working within them.64 In political science, the world of informal institutions have been elaborated within different fields of study as “prismatic societies”, “moral economies”, “economies of affection”, “legal pluralism”, “clientelism”, “corruption” and consociationalism. Some good examples of informal institutions, rules and norms are the Mexican “dedazo” (“big finger”), an unwritten code that gave the sitting president the right to choose his successor and prohibited potential candidates from openly seeking the job. In addition, the Japanese strict, but unwritten, rules of “Amakudari” (“descent from heaven”), through which retiring state

61 Boettke, "Institutional Transition and the Problem of Credible Commitment." P. 49
63 North, "The Role of Institutions in Economic Development." P. 2
64 Helmke, Informal Institutions & Democracy: Lessons from Latin America. P. 24
bureaucrats are awarded top positions in private corporations, have survived decades of administrative reforms. We will be crossing some of the above mentioned fields of study in this thesis.

It is difficult to create change to enhance performance. While formal institutions, rules and norms can be elaborated and established, the informal ones are often portrayed as highly resistant to change. Like culture, they are often assumed to possess a tenacious survival ability, which allows them to endure regardless of the formal institutional context. Change is expected to be slow and incremental because they do not possess a center which directs and co-ordinates their actions, however, Helmke and Levitsky argue that change within informal institutions may be more frequent than we often assume (as we will see in the idealist and pragmatic cycles of Cuban policies in chapter four). This would happen by actor beliefs about the opportunities and threats they face. If actors’ shared expectations about the costs or benefits of an informal rule should change, then informal institutions, even long established ones, may change quickly.

North argues that “organizations” are the primary source of institutional change; the greater the competition between organizations, the greater is the incentive to invest in skills and knowledge to enhance the organizations survival opportunities and hence the greater the rate of institutional change. In the case of Cuba, all economic organizations are state institutions; I therefore choose to refer to them as institutions. Since organizations are the agents of change in an economy, a change in the bargaining power of existing organizations will lead to alterations in the institutional framework. A decline in the perceived effectiveness of existing organizations will weaken their ability to maintain and support the existing institutional structure. Changes in the formal rules come through the polity (broadly encompassing the judicial, executive and legislative branches). Successful economic growth has historically been linked to the evolution of representative government, and secure property rights through the rule of law. What is not accounted for is how we explain growth in some modern economies which have not evolved representative institutions and has had government corruption and mismanagement strangle economic opportunities (Cuba, Vietnam, China).

65 "Informal Institutions and Comparative Politics: A Research Agenda." P. 725
66 Informal Institutions & Democracy: Lessons from Latin America. P. 24
67 North, "Institutions and Credible Commitment." P. 19
On this notion, I present some basic assumptions of what needs to be present to enhance the credibility of an actor. First, as mentioned above, formal rules are an important part of the institutional framework. For them to be effective they need to be accompanied by a set of informal constraints (conventions, norms of behavior) that supplement them and reduce enforcement costs. Political instability occurs if the formal rules and informal constraints are inconsistent with each other. The political consequence is that it takes more time to develop norms for behavior than it does to shape formal rules, and for the economies without any traditions for these types of norms, the reconstruction process is long and the result unknown. Second, the objective by reconstructing must be the creation of an adaptively efficient economy that over time will provide an institutional framework for a wide menu of alternative choices for organizational innovation and also wipe out failures, and to create an institutional framework that will get the prices right over time. A successful restructuring of an economy entails a restructuring of property rights to provide the “correct” incentives and a restructuring of the mental model of the players to induce choices that are complementary to such incentives. To restructure does not only mean to create formal rules, but also to create and implement a legislation that will be impartially enforced. It may be too much to demand from a state under reconstruction to comply with all of the assumptions above, but to a certain degree, it would enhance the credible commitment of a host nation.

2.2.4 State/economy/ & society/cultural heritage

This section should be read in context with chapter 4. North addresses the complexity of the nature of states, economies, societies, the interplay between beliefs systems and their cultural heritage, and how they interact with institutions. Borrowing rules from other societies that have different informal norms and different enforcement characteristics is a guarantee for failure. One has to be conscious about the role of changes in formal rules and how they are complemented, supplemented or influenced by norms of behavior. This may be different in every society, and neo-classical economists have gone into countries and said that all you have to do is to set the “prices right” and everything will work (over simplified). Too many times this has had negative consequences for the country’s economy. Not only do you need to know about the background and the cultural heritage of a society to have an understanding of

68 Ibid. P. 18 - 22
69 Ibid. P. 18-22
70 Ibid. P. 18-22
the relationship between formal and informal norms, but you also need to be aware of the margins where changes will be effective and what the implications of those changes will be for complementary informal norms and enforcement characteristics.\textsuperscript{71}

The economic institutions that directly shape our world derive from political institutions. Economists might not like to think they are dependent on political sciences, but they are. The interesting thing about the institutional theory is that it wishes to address who makes the rules and for whom, as well as recognizing the formal rules like constitutions, laws, rules and regulations. Therefore, we need to see who make the choices that matter, how they get aggregated, and how that turns into polity that makes the rules which in turn shape the economy. The economic rules of the game are made and put in place by polity. This concerns property rights, and this is important to our case because property rights do not only encompass rules about how property is used, alienated and owned, but also the effectiveness of enforcing contracts and agreements in laws. It is a political structure that in turn puts in place an economic structure that shapes how that society works.

Many Latin American states have failed to uphold or enforce the rule of law; the laws and rights are therefore not executed in a proper manner. The effectiveness, and the extent to which rules and procedures that exist on paper are enforced or complied with in practice, is important. Where formal rules and institutions are effective, actors believe there is a high probability that noncompliance will be sanctioned by official authorities. Where formal rules and procedures are ineffective, actors believe the probability of enforcement to be low.\textsuperscript{72} North also points out that polities are the fundamental obstacles to our ability to improve performance because we do not know how to get polities to work well, and Cuba has a long history of ad-hoc policies to make economy and socialist ideas comply with each other. Cuba being a communist state with all power gathered in the party, and above all in one person, the enforcement of law appears dubious at best.

The set of rules, norms and beliefs that have survived through history are deeply embedded in our cultural heritage and society. The cultural heritage produces a mix of good and bad that shapes the way in which we make choices and the ways in which societies and institutions evolve.\textsuperscript{73} This is important as I address what is the Cuban contextual point of view as they introduce reforms to facilitate FDI inflow, and why the obstacles that exist have occurred. The rich institutional heritage of political, economic and social rules combined with

\textsuperscript{71} “The Role of Institutions in Economic Development.” p. 7
\textsuperscript{72} Helmke, \textit{Informal Institutions & Democracy: Lessons from Latin America}. P. 13
\textsuperscript{73} North, “The Role of Institutions in Economic Development.” P. 4
a belief system have evolved and together shaped the way we see the world, the Cuban socialistic way of seeing the world included.

The cultural heritage and belief system produce results with respect to the way problems are approached in the world. This implies that we started with a set of beliefs that we derived from the past, then we got new experiences that modify that belief system over time. The heritage itself and experiences shape the way we understand the world around us.

Beliefs are, according to North, everything in the world. Where they come from and how they evolve is the key to understanding the evolution of human condition, they are generally derived from the historical experiences of human beings in different physical settings. There are numerous factors that shape how people make choices, bear in mind that by people, we mean everyone from head of state to policemen, economists, terrorists, beggars, doctors, etc. In addition to the cultural heritage and experiences they have had, there are political systems. As economy moved into politics it carried over the principles of economics and applied them to politics, but politicians are never disinterested, and they are always concerned with a certain kind of objectives, the Cuban government included. However, we do not know how to create polities that work; even if we have a lot of practice around the world trying to restructure polities, we have very limited ability to do so.74

Lower information costs now make us more aware of alternatives around the world, and therefore increase our ability to see different kinds of experience and different experiences of success or failure. To some extent, we have increased knowledge about the sources of productivity and what makes polity work. When we put all the previous factors together, we have forces operating in conflicting ways. Bad performance arises from institutions that are inherited from the past and constrain our behavior, or from a polity that does not work well and has in place people with a vested interest in perpetuating inefficient rules of the game, but it also has generated lower cost information, and an improved understanding of what makes economies work.75 The Cubans also look outward to find the best ways to incorporate an economic transformation that Fidel swore never to be a part of, the neoliberal capitalist game that turned the world into a casino. Their cultural heritage, though, may make them search for other things than the “western countries” assume they will be searching for.

74 North, "The Role of Institutions in Economic Development." P. 4-5
75 Ibid. P. 5
To the degree problems are evolving, we must evolve political, economic and social institutions, which will solve those problems. North calls for the need of “adaptive efficiency”, which occurs when there are flexible institutions that provide a maximum of choices at a given moment of time. In a world of uncertainty, in which nobody knows the right answer, you need to try many of things and hope you will find one that works. You also need laws and rules, such as bankruptcy laws, that eliminate those that do not work. A society with such an institutional framework has a good chance of being successful in surviving and continuing to perform well.  

2.2.5 Level of commitment and liberalization

While North focuses on the importance of institutions, organizations and the informal norms that needs to accompany the formal, J.P Singh investigates what is the key to attracting FDI by strengthening ones credible commitments both internationally and domestically towards liberalization reforms in different sectors. Singh focuses especially on the Asian telecommunication market, but we are able to draw general conclusions on the results presented by Sing. He focuses on the formal reformation processes that contribute to strengthening credible commitment through international, and domestic, treaties and liberalization reforms.

The degree of commitment is categorized by:

- “Strong commitment” referring to those states that open their markets in a considerable number of sectors and areas.
- “Reasonably strong commitment” is those who seek to adopt measures to open markets in various areas and sectors two to four years after having committed themselves to GATS.
- “Weak commitment” is those who delay the introduction of reforms to after four years with a weak commitment to future regulations.

The degree of liberalization is categorized by:

---

Ibid. P. 9
“Strong liberalization”, means basically private competition, and a significant presence of foreign actors.

“Reasonably strong liberalization”, means at least liberalization of markets in value added and specialized services with some foreign entry for operators and users allowed.

“Weak liberalization” refers to those countries still waiting to introduce any significant competition in any market segment, and that still wait to pass major laws changing the role of their monopoly operators.

Those countries that executed a considerable liberalization of their domestic markets were also considered to have strong commitment. The same connection could be drawn between reasonably strong commitment and reasonably strong liberalization, and weak commitment and weak liberalization.77

Still, as mentioned in section 2.2.1, an international commitment alone will not be enough to attract FDI. The degree of divergence from the national liberalization program is reflected in the degree of variation of flows of FDI. Most existing commitments at the international level reflect commitment level domestically. The question is: where does Cuba locate itself in Singh’s categorization and are the results compatible with this theory? Cuba’s signing of the GATS (General Agreement on Trade in Services) agreement in 1995 could be used to determine the grade of liberalization and commitment shown by Cuba. It was a good tactic to promote law 77 on FDI in hope of attracting investment. Still, I suggest that in our case we first look at the period between 1995 and 2006 to establish the initial grade of liberalization and commitment. Secondly, we address the period from 2007, and the “cycle of restructuration” that Raúl initiated (also referred to as the “liniamientos”) until present day.

2.3 Summary

We have already established that FDI does not automatically lead to prosperity and growth without the creation of a proper environment for absorption. If the environment is not optimal, the countries may have to choose between short term and long term beneficial investments, which may lead to static gains, but leaving dynamic ones out. The reasons for host nations to use FDI as a strategy for development can be measured in direct and indirect effects;

77 Singh, "Fdi Credible Commitment." P. 80
1. FDI as a direct effect brings capital that can be used on the international market.
2. The indirect effects of FDI come through spillovers to society from wages, technology, skills and management, market access, environmental policies and technology, and more.

The sites that will receive most FDI are those that allow foreign companies to set up facilities able to withstand global competition. The host country has to provide competitive immobile assets through skills, infrastructure, services, supply networks and institutions, to complement the mobile assets of foreign companies. Growth can be sustained only if countries can create new, higher value-added activities that hold their own in free markets. It requires a lot, but the ability to use new technologies efficiently, and furnishing the requisite skills and strong institutions are central to the host nations.

With this in mind, it is clear that Cuba does not comply with all of the demands the theory presents. Rather, Cuba has its own way of understanding how FDI should be implemented and explored. They are currently using a much criticized method of “free trade zones”, at the same time as Raúl himself have declared all sectors of the economy opened except health, education and the military. If FDI is to flow into Cuba, we need to take a look at how it could work on Cuba. It may be that the idea Cuba has of FDI will not work when put to life, though it would work perfectly in a vacuum.

Addressing institutions in section 2.2.2, we notice that they are slightly more difficult to classify than what is FDI. They exist in every form in our daily lives and are central to our understanding of the world. Institutions reduce uncertainty in the world, so that we can know how to deal with each other. On the philosophical level, institutions are the incentive systems that structure human interaction, reduce uncertainty in the world as we go on with everyday business, and solve problems effectively. They provide incentives and disincentives for people to behave in certain ways.

What is interesting for our case is that if the institutions are effective, they can structure and provide incentives and structures for economic, political and social activity. We do not live only in an economic world, a political world or social world, but in a world that consists of a mixture of all of them. The institutional theory I am using in this case will

embody all of them on some level, but I will focus on those affecting the FDI paradigm. Also, the interplay between beliefs systems and the cultural heritage, and how they interact with institutions, is of a highly complex nature. It will be impossible to give a whole definition of actual factors affecting FDI inflows, but I will elaborate on the very central formal/informal rules and norms that we can identify.

The economy, politics, and society are the three central factors I will be focusing on in the analysis, see table 1. Within the three of them, we can find a path to realize a higher degree of credible commitment. The institutions are made up of formal rules like laws, constitutions, regulations, and have the character of being specific and precisely defined. The informal norms and constraints are ways of doing things, and compared to formal rules they have a much greater effect on everyday behavior and actions. They do not appear in formal terms, but may have great effect on end results of formal legislations. One has to be conscious about the role of changes in formal rules and how they are complemented, supplemented or influenced by norms of behavior. What follows is a model I have constructed to help us focus our attention towards the FDI sector.

<table>
<thead>
<tr>
<th>Factors &amp; Cultural heritage</th>
<th>Formal Rules and Norms</th>
<th>Informal Rules and Norms</th>
<th>Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economy</strong></td>
<td>Central Planned Mechanisms in free zones</td>
<td>Behavior</td>
<td>The State</td>
</tr>
<tr>
<td></td>
<td>Law 77 and Law 118</td>
<td>Actions</td>
<td>CCP</td>
</tr>
<tr>
<td></td>
<td>Property rights</td>
<td>Commitment</td>
<td>MINCEX</td>
</tr>
<tr>
<td></td>
<td>Commitment through law</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Constitution</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Politics</strong></td>
<td>Law 77 And Law 118</td>
<td>Behavior</td>
<td>The State</td>
</tr>
<tr>
<td></td>
<td>Free Zones</td>
<td>Ideology</td>
<td>CCP</td>
</tr>
<tr>
<td></td>
<td>Property rights</td>
<td>Rhetoric</td>
<td>MINCEX</td>
</tr>
<tr>
<td></td>
<td>Commitment through law</td>
<td>History</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Constitution</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Society &amp; Cultural heritage</strong></td>
<td>Education</td>
<td>Belief</td>
<td>The State</td>
</tr>
<tr>
<td></td>
<td>Laws</td>
<td>History</td>
<td>Education system</td>
</tr>
<tr>
<td></td>
<td>Constitution</td>
<td></td>
<td>Belief system (Cuban Socialism)</td>
</tr>
</tbody>
</table>

*Table 1: Factors to be considered

Source: Own table*
On the basis of the theory, this model should help us as we address the Cuban case. As formerly mentioned in this chapter, we need to see who makes the choices that matter, how they are aggregated, and how that turns into polity that makes the rules, that in turn shapes the economy. In our case, that means the Cuban government, the “Ministerio del Comercio Exterior y la Inversión Extranjera” (MINCEX) institution and the laws enacted the last decades. The economic rules of the game is made and put in place by polity. It is a political structure that in turn puts in place an economic structure that shapes how that society works. In section 2.2.1 we elaborated on the term credible commitment; it is the degree of security a host nation can give to foreign investors or “how to bind players to agreements across space and time”, as North puts it. In accordance with the institutional theory, I find that there are four points important to elaborate in my case.

1. To investigate the formal rules and the set of informal constraints that accompany them, and how the outcome on the level of credible commitment will be if they are inconsistent with each other.

2. Reviewing the existing organizations/institutions that deal with developing the FDI sector, and analyzing the assertion that the competition and bargaining power between them causes alteration in the institutional framework. Also, to look if the objective of structural reforms really is to create an adaptively efficient economy that will provide an institutional framework, or to maintain political status quo on one hand while generating wealth to the state on the other.

3. To address if the changes in formal rules have contributed to successful economic growth; or if there is a need for a more representative government and enhanced property rights.

4. Also, to elaborate if cultural heritage and mental models affect the outcome of the FDI sector and if Cuban government is prepared to actually reform, or whether they will turn back to “idealism” in the context of the inevitably painful period of reconstruction.
3 Methodology

The methodological outline of this thesis is presented in this chapter. I will start by giving a description of the case study, based on the literature of Robert K. Yin, 79 and justify why it is applicable to the case of FDI presented in this thesis. Then I will present my research design to give transparency to the various steps of the study. The validity and reliability of the data applied is discussed in the following section, as is how the data was collected. At the end of this chapter, I discuss various biases and limitations of the chosen methods, empirical data and analysis. Though I use general theory of case-study research, I focus on presenting what is specifically good, and not so good, in my case-study.

3.1.1 Why a Case Study?

The case study is one of several ways of doing social science research. Each method has its advantages and disadvantages. Yin presents the case study as a preferable method when three conditions are in place;

(a) When “how” and “why” questions are being posed, (b) the investigator has little control over events, and (c) the focus is on a contemporary phenomenon within a real life context. 80

This situation distinguishes case study research from other types of social science research. Still, methods all overlap in many ways, and are not marked by sharp boundaries. The case study is considered a “soft” form of research. Still, as there will be many more variables of interest than data points, an essential tactic is to use multiple sources of evidence with a triangular conversion of data, which makes case study “hard”. It has been a common research method in psychology, sociology, political science, anthropology, social work, education, nursing, and community planning, and even in economics. All disciplines have their distinctive need for a case study approach to understand a complex social phenomenon. The case study method allows us to retain the holistic and meaningful characteristics of real life events. 81 This case study is conducted with qualitative research, because it is used to uncover essential features of a case (FDI, credible commitment and institutions) and then

80 Ibid. P. 2
81 Ibid. P. 4
illuminate key relationships among these features. However, the case study method goes beyond being a type of qualitative research. It uses a mix of quantitative and qualitative evidence, which I take advantage of in this case when I focus on numbers and statistics on FDI.

Due to the economic limits and timeframe, the case study approach suits the objective of this thesis. It allows for an exploration of different aspects of the Cuban struggle for credible commitment through analyzing the authority’s goals with the FDI policy and the existing obstacles within the institutional framework. This approach also takes contextual factors into account. The difficulty of accessing credible data also makes the case study especially suitable, as case study research does not discriminate between different types of data collection methods. As this thesis focuses on contemporary (last 20 years) events, the case study is the preferable choice of method. However, I also use the historical context to establish the “economy/state” and “society/cultural heritage” background to the case. It is manageable as the case study and history relies on many of the same techniques.\(^8^2\) In conducting a case study, my goal is to expand and generalize theories (analytic generalization) and not to enumerate frequencies (as in statistical theories). The central tendency among all case studies is that they try to illuminate a decision or set of decisions: why they were taken, how they were implemented, and with what result.\(^8^3\) This is exactly what I do when I analyze policies and the execution of policies towards the FDI sector by the Cuban government. Yin’s technical definition of case studies is that:

“A case study is an empirical inquiry that a) investigates a contemporary phenomenon in depth and within its real-life context, especially when b) the boundaries between phenomenon and context are not clearly evident.”\(^8^4\)

The Cuban contemporary struggle for credible commitment and FDI is based on the boundaries that exist between the context of Cuban institutional development and the execution of formal rules through informal norms. Therefore, I chose to use the case-study approach to understand a real-life phenomenon in depth, but it encompasses important contextual conditions. I use Yin’s fifth “rationale” for a single-case study, where I study the case at two different points in time (1995-2006 and 2007-2015). With the established theory, I

\(^8^2\) Ibid. P. 11  
\(^8^3\) Ibid. P. 17 
\(^8^4\) Ibid. P. 18
specify how certain conditions change over time. It is a holistic design, which studies the nature of Cuba´s FDI paradigm.

The case study is also a form of inquiry that does not depend solely on ethnographic data (long periods of time in the “field”) or participant observer data (also a circumstantial investment in the field). It is possible to do a valid and high quality case study without leaving the telephone or internet, depending upon the topic being studied.85 Because I wish to understand complex social and economic phenomena, the case study method allows me to retain the holistic and meaningful characteristics of real life events, such as behavior, international relations, maturation of industries and organizational and managerial processes.86 There are many well-elaborated studies on the Cuban economy, and FDI is a part of it most studies, by “Centro de Estudios de la Economía Cubana de la Universidad de La Habana” (CEEC), and also external institutions. However, there is no extensive amount of literature investigating Cuban institutions and the relation between institution, credible commitment and FDI on Cuba.

3.1.2 Research Design

I am studying why the inflow currents of FDI have been absent even though the Cuban government has introduced a variety of different liberalizing reforms. I do this by analyzing formal and informal rules and norms within the institutions that handle FDI, to see how it affects Cuba´s level of credible commitment, which reflects investor´s will to invest in the island economy. To do this, I examined several studies on similar topics within the FDI and institutional paradigm before I narrowed down my interest to a key topic, which I formulated in the questions in chapter 1.2, “defining the case”. I created the questions on the propositions that formal and informal rules and norms affect Cuba´s credible commitment, which again affects inflow currents of FDI.

Even though the case study does not demand a clear preference of research design, certain steps had to be taken to advance from initial research questions to concluding answers. This had to be done in an order that firmly addressed the questions. I chose to introduce a general theory on the FDI, where direct and indirect effects of spillovers were the main focus states look to as they wish to introduce FDI to their economy. Second, I presented theory on what kind of conditions need to be in place for FDI to work. Here, I chose institutional theory.

85 Ibid. P. 15
86 Ibid. P. 5
on institutions and credible commitment to elaborate on what I would like to investigate concerning the lack of inflow currents of FDI to Cuba. Chapter 4, is a contextual chapter that help us understand how the institutional framework and political design of the Cuban system has evolved. I use the idealist and pragmatic cycles of Mesa-Lago as a framework. In this way I establish what is Cuba´s context as the government introduces new reforms to attract FDI, which makes it easier to analyze formal and informal rules and norms, and reflects the proposition I made in the introduction.

![Research Design](image)

**Figure 3: Research Design**

**Source: Own figure**

The research design in figure 3 appears more neat and consistent than the actual process has been. In reality, I have gone back and forth between the different stages as the thesis gradually formed itself, and it became clear which questions I could answer based on the existing material and timeframe.

Initially, the general topic of my thesis started with a plan to write about FDI and Cuba. Through literature on Cuba´s economy, it appeared to me that there were several obstacles to why FDI remained hesitating, and the same obstacles were generated through the
in institutional framework of policy and economy concerning FDI. In the beginning I spent much time reading theory on FDI to get a general understanding on how it works and how I could use it without involving unnecessary information about its effects on society. I participated in the Norwegian Latin America Research Network master course, once before I had found a topic and a second time where I got help narrowing down and focusing the topic I had chosen. The course was initiated by the center of development and environment (SUM) at UiO. The institutional theory and the theory on credible commitment I mostly found through the works of Peter North. His theories and works were frequently mentioned, or built on, by other authors writing on similar topics. Finally, I investigated several books, articles, reports and official information on Cuba’s political and economic history since the revolution, with the emphasis on the FDI sector. With the literature on theory in mind, I extracted events and actions by Cuban government I found important to the forming of the institutional framework for FDI that became relevant with the introduction of law 77 in 1995.

I have favored a broad approach to the research, wanting to study the case from at least two different angels: the investor’s angle, which mainly appears in chapter 5; and Cuba’s angle, mainly presented through their political, economic, societal and cultural heritage context in chapter 4. A third approach to the case is the objective research, building on what theory on FDI, institutions and credible commitment states, and the findings I have made in the last part of chapter 5.

### 3.2 Sources of Data

This case study is mainly of a qualitative nature, and this method is best understood as a data enhancer. This means that when the data I used is enhanced, it is possible to see key aspects of the case more clearly. However, this depends on how I search for hidden meanings, non-obvious features and multiple interpretations. When certain aspects of the data are enhanced, it is possible to see certain aspects more clearly. When qualitative methods are used to enhance social data, researchers see things about their case they might miss otherwise. The key to bringing in-depth knowledge to light is through data enhancement.\(^\text{87}\)

Because of the limits of a master thesis, it was important to consider which theory and material I wanted to work with. I chose several academic articles on Cuban economy as they are thoroughly elaborating important elements concerning FDI and my thesis. To get a better

understanding of investor’s position towards investment on the island, I have used articles and interviews in “Financial Times” and a report written by CEEC. In terms of the investment environment on the island, I particularly wanted to analyze the two laws specially constructed for FDI: Law 77 of 1995 and Law 118 of 2014. These two laws are the main contributions since FDI was permitted into the economy. However, the legal framework includes several more laws and declarations as seen in appendix II and III.

As mentioned above, the most available data I found in books, articles and archival records, while data that was harder to retrieve was statistics from governmental institutions, reports and interviews. On the basis of the data used, I have enhanced information that contributes to build my case, in favor of or against it.

3.2.1 The Unit of Analysis

The unit of analysis in this thesis is Cuba’s FDI sector. I have delimited the unit by focusing on functions within the institutional framework that contribute to a low credible commitment at international levels, which affects the inflow current of FDI. I chose specifically law 77 of 1995 and law 118 of 2014, as they were essential reference points for the timeframe in which most of the development in the FDI sector, since the start of the revolution, has taken place. I have narrowed down the analysis of Cuba’s FDI sector by presenting specific research questions and by selecting a theoretical framework that could provide structure for my analysis. The formal and informal rules and norms within the institutions, Cuba’s level of credible commitment, and the effect of, and on, FDI have been emphasized to the expense of other elements to Cuban economy concerning the FDI sector. Table 1 in section 2.3 gives a more detailed overview of factors considered to be of importance to the analysis.

3.2.2 Validity and Reliability

We need to have some criteria for trustworthiness, credibility, confirmability and data dependability in the thesis. This is done by taking “validity” and “reliability” into consideration as we ensure the quality of the research design and the investigation in the design process of the case study. According to Yin, to construct validity we have to use multiple sources of evidence, establish a chain of evidence and have key informants review draft case study report.88 I found that to construct validity I had to execute two steps:

88 Yin, Case Study Research : Design and Methods, 5. P. 40-41
1. Define the formal and informal rules and norms of the specific institutions (and relate them to the original objective of the study) and
2. Identify operational measures that match the concepts (preferably citing published studies that make the same matches).  

Furthermore, it was important to discuss how the shortcomings would not bias my study. Especially, since there are few studies dedicated to the change in informal rules and norms. I have generated validity in this thesis by using multiple sources of evidence and applying operational concepts commonly recognized within the FDI and institution paradigm.

According to Yin, for a study to be reliable, it has to minimize the errors and biases in the study to be sure that if a later investigator follows the same procedure and conducted the same case study all over again, the later investigator should arrive at the same findings and conclusion. The general way of approaching the reliability problem is to make as many steps as operational as possible and conduct a thorough analysis. True reliability could be hard to achieve in a case studying informality in institutions, therefore I have narrowed “informalities” to address “decision-making and actions” made by Cuban authorities toward FDI and foreign investors. The reliability is generated through the elements; formal rules and norms, credible commitment and FDI, which are well accounted for in the theory section in combination with transparency for the choices I have made, and the operationalization of data. Also, people central to this thesis, such as my supervisor, have read and commented on all parts of the thesis.

3.3 Collecting the Data

I am member of the network “Ethno Cuba”, a group of academics that have written or are currently writing about Cuba. In this network there are academics from all over the world, within all categories, most of them with a PhD (Most of the work generated from this network can be found on http://cubacounterpoints.com/). I was able to establish connections with several academics that could help me with data. However, few of their contacts were willing to contribute by giving an interview. Eventually I found the timeframe of the thesis too short to be able to find sources and conduct sufficient interviews that could generate a

---

89 Ibid. P. 42
90 Ibid. P. 45
representative group. I also contacted Sherrit International, Nestle and Melía, where two of them politely rejected and the last never returned my requests. However, different embassies (Spain, Norway, Italy and Germany) could help with some “suggestions” if one were to invest on the island, and all of them referred to a report conducted by CEEC. I was able to retrieve this report from Ricardo Pérez Torrez, a CEEC professor of economics, who attended the conference I arranged with Vegard Bye in Oslo 2015.

In the theory-section I presented a wide array of literature concerning FDI. I decided to choose literature that covered most aspects of FDI as in Moran, Graham and Blomström and generalize on these findings concerning effects of FDI. I also used commonly accepted definitions of FDI used by the OECD and the “Advocates for international development”, also emphasizing the importance of investigating host nation’s definition to avoid any misunderstandings of the meaning.

Through key-words like FDI, institutions, credible commitment, used in archival records, digital databases, libraries and search engines, I found a wide range of information. I identified authors and themes that were frequently emphasized and referred to, and included them to establish a wider range of literature. To a larger degree I retrieved literature through tips from connections established throughout the thesis, and some documents from connections on Cuba not available through other digital searches. Because I master Spanish fluently, I was able to address, and include, documents and literature exclusively available in Spanish. This contributed to a more nuanced set of data, enabling me to address Spanish and Cuban writings on related themes. All in all I spent much time and effort reading and reviewing literature.

Conducting research in Cuba, and accessing informants, can be difficult. Through contacts established through former studies in Cuba during my 6 month stay in 2009, I was able to get in touch with some official sources. In contact with Cuban official sources, I presented the thesis as an objective research on how and why Cuba had not achieved a higher level of FDI inflows. I emphasized that even though there were external elements, most elements could be found within the Cuban system regarding the FDI sector. I was mostly directed to the official site for statistics on Cuba “http://www.one.cu/”, which was not particularly helpful as it is highly unstable and the data outdated. Also, as travelling to Cuba is expensive I tried to use my private tours to conduct interviews and data collection. Unfortunately my last trip ended with me being hospitalized in Havana due to a bacterial

91 Moran, Graham, and Blomström, Does Foreign Direct Investment Promote Development?
infection. Fortunately, I had the opportunity to visit several embassies before I got ill. As mentioned earlier, back in Norway, I organized a closed conference on the topic of Cuba’s future together with Vegard Bye (Norwegian writer and academic who specializes on Cuban economy), where several Cuban, and international, academics with special expertise on Cuban economy and political science participated. Ricardo Torres Pérez, whom I was to meet in Havana when I got ill, also came. I made important acquaintances, and received information on good and valid literature for my thesis. The conference made it possible for me to have detailed conversation about my thesis, and about limitations and biases that may appear during the investigation. I maintained e-mail contact with several of the participants, and used this means of communication with several of the authors I have used in the thesis. This conference treated the topic of Cuba’s future.

3.4 Analyzing the Data

There are especially two conditions that could be considered to weaken the data validity: the lack of interviews and a more thorough stay in Cuba, being closer to events and people dealing with the elements of this thesis. However, I chose not to include interviews as I considered much of the existing empiric material good enough to be analyzed and to answer my research questions. I had also established good connections that could provide me with relevant literature though they did not wish to be interviewed. Also, as mentioned above, the case study provides us with the possibility to study a large quantity of data without having to leave the PC or telephone.

The amount of data increased especially after 17th of December 2014, when the U.S. and Cuba began opening for normalization of the diplomatic ties. I had to narrow it down, as much of the material was of normative nature, trying to predict possible outcomes and ways for Cuba to proceed in the future. Still, it contributed to connections to literature and material that could be used in this thesis.

First, I wanted to analyze the material categorically by addressing FDI, then credible commitment, and finally, formal and informal rules and norms within the institutions. However, I found that the interconnection between the categories led to elements of them all being found in the material I studied. They are not mutually exclusive, so instead of isolating them, I tried to make apparent the interaction between them through data enhancement.
It was particularly difficult to decide which historical elements to include in this thesis. History should not be something “briefly introduced” if it is a part of the thesis. I therefore wrote the contextual chapter four several times, trying to emphasize elements which made the Cuban political, economic and institutional system what it has become the last 20-25 years. At the same time, I tried to angle it towards the FDI sector, but as this sector was excluded from the island much of the time covered, it was important to locate the events and policies that would later affect FDI. I found the idealist and pragmatic cycles of Mesa-Lago\textsuperscript{92} to be a good framework in which I could create this contextual framework. When the context was ready, I found that the present state of the political, economic and institutional system had to be analyzed. First, I wanted to address the economic freedom, as this was an important obstacle for investors, and contributed to explaining the lack of FDI. Second, I found that analyzing Cuba without comparing it to similar cases, would damage the validity of the thesis. At the same time I did not wish to do a comparative analysis of two cases, I therefore mention Vietnam and China as ideologically close to Cuba, and the FDI sector of Dominican Republic to show a more or less same sized economy. The poor Cuban results, concerning FDI, became clearer in this context.

It was difficult to find quantities of empirical data on informal norms and rules; this made me change tactics. I found that I had to address the formal rules and norms and see if they were consistent with what the Cuban government actually did decide. I found Law 77 and 118 to be the most important formal norms and rules concerning FDI, even though there were several other pro-market economic reforms that concerned the topic. During the process, I also learned that the decisions and actions made by the Cuban state (including state institutions) were the most important informal elements. You may say that Cuba, being a single party state with a centralized political and economic system, made the analytical process “easier” as decisions and actions had all been taken from state level.

There were also two overlapping themes that I found important to address in order to elaborate further on the investment environment for FDI. First, both Cuba and the foreign investors saw the U.S. embargo as an obstacle of considerable size. Secondly, the special development and economic free trade zones were, in the minds of Cuban authorities, a measure that should be acknowledged as “willingness” and “dedication” to further, develop the investment environment. However, the free trade zone had not generated the results that Cuba had planned for, as the investors mention several obstacles of informal nature.

\textsuperscript{92}Mesa-Lago, \textit{Cuba En La Era De Raúl Castro: Reformas Económico-Sociales Y Sus Efectos}. 
Therefore, these two themes became relevant as they contributed to establishing that the obstacles for FDI went beyond the formal initiatives.

On the basis of the empiric material, I found that what needed to be discussed was the level of credible commitment and how Cuba was perceived as an actor amongst investors. I used the theory and the analysis to generate the results on how inflow currents of FDI were affected by how Cuba scored on the level of credible commitment. This again I used to establish a conclusion.

3.5 Biases and Limitations

Perhaps the most difficult part of the thesis was to get a hold of statistics on official numbers and reports. I had to go through informal channels to meet representatives of the CEEC. Cuba is known for being a closed source of information, and will direct you to their official statistics located in the webpage mentioned above. I had to rely on sources not directly involved with day-to-day activities in the Cuban FDI sector or other official institutions. This thesis addresses a somewhat sensitive topic as it implies that there are errors in the system that handles FDI, which gives root for critique of the regime. Critique of Communist and authoritarian states is not always welcomed, but I do not focus on errors of the system by constructing the thesis as a critique, rather I investigate the Cuban context and match them with theory on FDI and investor´s concerns.

In my readings and reviews of literature, I found that several authors emphasize the difficulties of extracting exact data. Spadoni states in his book “Cuba´s Socialist Economy Today”:

“Any attempt to carry out a study of foreign investment in Cuba is hindered by the lack of comprehensive and reliable information on the activities of foreign firms and their contribution in terms of capital. Due to what Cubans call the “US economic blockade” against the island, public disclosure of data on the presence of foreign capital in Cuba is mostly limited to statistics on the evolution of international economic associations by year, by sector, and by country. This method of reporting the level of foreign investment in the country offers no idea of the value or strategic importance of the deals involved.”

I use some of Spadoni´s statistics as he makes use of official reports that are not easily accessible, along with additional information collected from a variety of sources. Even

---

academics and professors employed at the CEEC struggled in their report\textsuperscript{94} to retrieve trustworthy data.

\begin{quote}
“La elaboración del presente documento también ha sufrido la dificultad en el acceso a datos estadísticos sobre el sector de IED en Cuba, por lo que su mayor valor tal vez radica en la recopilación y organización de información que en la mayoría de los casos se encuentra dispersa, así como, en los análisis y criterios que se van exponiendo sustentados en investigaciones académicas y en intercambio con especialistas, actores claves y representantes de los Estados Miembros de la Unión Europea en la Isla. Los datos utilizados en muchos casos son estimaciones considerando distintas fuentes, por lo que no tienen que coincidir con las estadísticas oficiales de Cuba y la UE.”\textsuperscript{95}
\end{quote}

This does not imply that there are no strategies to reduce the bias of the study. Yin states that one test of selection bias is to assess your degree of openness to contrary findings. I mostly found contradictions in theories of FDI functionalities, and to some degree different understandings of the definition of “institutions”. On the other hand, most of the literature concerning the FDI sector had the same conclusions regarding what needs to be done to liberalize the economy. However, many of the authors focus on the formal elements, but I introduce, focus and build on the informal elements North addresses in his theory.

\textsuperscript{94} Omar Everleny Pérez Pavel Vidal Alejandro and Villanueva y Saira Pons Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba," \textit{CEEC} Versión Final (2012).
\textsuperscript{95} Ibid. P. 5
4 Cuban Political, Economic and Cultural Context

Referring to figure 2, I will in this chapter be elaborating on the “right” part of the model and the section of “Economy/State & Society/Cultural heritage”, also found under “factors” in table 1. In the next chapter, the “center/left” part of the model and the elements concerning formal/informal norms and rules within the institutions, and the effect on credible commitment and FDI, will be elaborated upon.

In this chapter, I address some of the Cuban revolutionary history with capitalism and the “western” democratic system before I address the historical events that shaped the mental models that came with the belief system that institutionalized itself from the revolution until the fall of U.S.S.R. This will be of importance as many fail to understand the Cuban experience with capitalist functions and dynamics, and how history shapes institutions and decisions of present policies and reformation. I will be using Samuel Farber to explain how the Cuban rebellion rapidly evolved from a multiclass, anti-dictatorial movement into a full-fledged social revolution. 96 Also, the historical timeline of Skidmore and Smith is comprehensible and their writings focus in a large degree on politics and economics. 97 Carmela Mesa-Lago have made a very interesting investigation addressing the revolutionary “cycles” of policies and the rigid political and economic system of Cuba, which helps us to observe how the revolution was governed between idealism and pragmatism. This investigation will be the framework for my context chapter. 98 The extended picture of the Cuban context also helps us understand policies made towards the FDI sector.

The historical development of Cuba has been deeply affected by its location in the center of the Caribbean, as it lies within a network of vital sea lines. The Cuban economic development has been a typical tropical-American one, with a mono-cultural, slave-based, export-oriented agricultural society. 99 The political experience was a rather typical Latin American one, with the USA “controlling” economy and democratic processes. The Cuban governments of the 1920s and 1930s were among the most corrupt and brutal in the republic’s history, and Gerardo Machado (from 1925) used his executive powers to make himself

---

97 Skidmore and Smith, Modern Latin America.
98 Mesa-Lago, Cuba En La Era De Raúl Castro: Reformas Económico-Sociales Y Sus Efectos.
99 Skidmore and Smith, Modern Latin America. P. 296
unbeatable at the ballot box.\textsuperscript{100} There was also little change between 1934 and 1959. The electoral system had proved futile over and over again as the perennial strongman worked his will. All Cuban nationalist movements were rendered impotent next to the unbeatable combination of the Cuban elites, their political and military handmaidens, and the U.S. This strong group maintained the status quo as they maneuvered through democratic policy and capitalist economy. Still, in the shadows a socialist revolution began to materialize.\textsuperscript{101}

4.1.1 Towards Communism: the emergence of Cuban Socialism

In this section, I wish to address the events that contributed to Cuba´s socialism through the steps taken by Fidel Castro and his Revolutionaries. It is important to understand the policies that occurred during the Cold War era, until the fall of the Soviet bloc, as Cuba played a major symbolic role in Latin America, the Soviet regime and the U.S foreign policy. Through past events outlined in this section I clarify how Fidel Castro´s revolutionary policies could survive economic hardships and institutionalize through the last part of the 20\textsuperscript{th} century. This will let us recognize the creation of an institutional framework that exists within the rigid system of what is today´s Cuba. This is important if we want to understand how it affects the country´s credible commitment and inflow current of FDI. The political analysis of Cuban socialism and Fidel´s policies is as vast as theory on FDI, but I will explain some of the most relevant events for our case.

Fidel Castro represented an old Cuban tradition as an heir of a peninsular who had “made America”. Fidel, though, was not interested in enjoying the comfortable life his background and training in law could bring. He wanted a different America and proved to be strong-minded, articulate, ambitious and passionately nationalistic.\textsuperscript{102} Fidel was in strong opposition to the Batista tyranny, and he led a band of 165 men to attack the provincial army barracks at Moncada, Santiago July 26, 1953. The ambush did not succeed and most of the rebels were incarcerated or executed while Fidel and his brother Raúl were both sentenced to 15 years in prison. However, in an attempt by Batista to court public opinion, they were both released after 11 months. They immediately fled to Mexico to begin organizing a new revolution.

\textsuperscript{100} Ibid. P. 302
\textsuperscript{101} Ibid. P. 304
\textsuperscript{102} Ibid. P. 305
During 1958, Fidel had already managed to establish a base in the Sierra Maestras with Che Guevara and his companions, from where they launched guerrilla attacks and spread propaganda against the sitting regime. Batista replied with paranoia and counterterror, and in that way he enlarged the support for Fidel and his band of revolutionaries, while the support for Batista himself evaporated. His greatest strength had been to maintain order and status quo, but now this was disappearing, as torture and executions only produced new rebel adherents. The U.S had great interest in the island, and had no reason to support a dictator that had outlived his time. New Year’s eve he called his aides together, designated a successor president, and took off with a planeload of relatives to the Dominican Republic. On the 1st of January, Fidel Castro entered Havana in triumph, and crowds went wild in the cities.

These were the events that would lead to a new political and economic reality in Cuba. There is always a battle on history, and conservative exiled Cuban economists claim that Cuba’s prerevolutionary economy was extraordinary. According to them, the problems lay in the lack of a sufficient political and social consciousness and maturity, and not in the lack of economic development. In the other camp, supporters of the Cuban regime, as Francisco López Segrera who follow the dependence school, perceive only economic underdevelopment in prerevolutionary Cuba. According to Farber, both these camps have self-serving distorted views. The prerevolutionary Cuban economy featured contradictory and uneven development. For Fidel Castro and the members of the radical and politically conscious circles close to him, the problems of Cuba’s economy and society, and the failure of previous reforms, made the revolutionary road a possibility grounded in Cuban realities. The revolution would be a conscious choice compatible with the objective need to eliminate the contradictions of the Cuban economy and there would potentially be popular support for radical social transformation. At this moment the FDI was considered an imperialist means to control and extort resources from their “colonies”, and would not receive much thought and space in any economic policy, other than being expropriated.

Fidel did not have any clear policy as he entered the political vacuum Batista left behind. His political ideology before he came to power remains unclear to this day, despite his claim that he had been strongly influenced by “Marxism-Leninism” before the revolution. The rebel army was to remain the key political institution. Fidel’s greatest asset, aside from his gift of leadership, was the desperate desire for change among his fellow

103 Ibid. P. 308-309
104 Farber, The Origins of the Cuban Revolution Reconsidered. P. 33
105 Ibid. P. 34
Cubans. The underprivileged, the rural poor, and the working classes in the cities had never counted for anything in the electorate system. In April 1959, he set out for New York to visit the UN headquarters. The visit was probably a success from Fidel’s side, as he managed to project the image of a nationalist reformer, strongly opposed to foreign intervention, but also not a communist. Fidel hammered on the need for radical reform in Cuba, especially land reforms. He expropriated farmlands with compensation to be paid in Cuban currency bonds. Foreigners would henceforth not be allowed to own agricultural land. The land was to be handed over to small private holders and cooperatives. This rang the alarm bell in the U.S as Fidel took quite communist measures to address his new gained country’s problems. This was also the start of a difficult relationship with FDI, which would be a highly appreciated means for development by developing countries during the last half of the 20th century.

In Fidel’s “second declaration of Havana”, his feelings toward the international economic and political leading sphere were condemning and overall negative. What policies were the U.S to expect from their neighbor with such a condemning rhetoric against western culture of economic and politics? We frequently apply the model of West European and North American political experiences to Cuba, and attempt to find familiar political and economic currents: conservatives, Communists, social democrats, or U.S-style liberals. These currents do not accurately portray Cuba’s political economic universe, which evolved in response to a variety of historically grounded issues and needs. To answer the initial question, we have to look towards a Cuban and Latin American political tradition that has often been downplayed or ignored, namely “populism”. Fidel Castro always resisted subordinating himself to any organizational apparatus and his considerable political talents were eminently tactical. His leadership resembled the Latin American phenomenon of “Caudillismo”, except Fidel Castro was a caudillo with political ideas. Although he did not necessarily foresee membership with the Soviet bloc, he did not preclude it a priori.

Carmela Mesa-Lago addresses Cuban policy and the social-economic evolution from 1959-2012. To understand the reforms introduced by Raúl Castro (from 2006), he focuses on so-called “ciclos idealistas y pragmáticos”. He finds that the social-economic policy has changed ten times, each time seeking to shape Cuban economy, policy and society. The cycles that were of anti-market rhetoric are called “idealista” while those applied towards the

106 Skidmore and Smith, Modern Latin America. P. 310
109 Ibid. P. 63
110 Mesa-Lago, Cuba En La Era De Raúl Castro: Reformas Económico-Sociales Y Sus Efectos.
market are called “pragmatic”. The idealist cycles were very ambitious and contain goals for achieving the largest industrial production per capita in Latin America, or produce 10 million tons of sugar and double it, create the “new altruistic man” and other great projects which all failed, leading to crisis in most cases. The pragmatic cycles have produced moderate results in the economy and in living standards, but also created some negative social results, like higher unemployment rates and inequality. If a pragmatic cycle failed, an idealistic cycle was the answer, and vice versa, which created a vicious circle.111 I use this historical framework as it provides insight into the inconsistency of Cuban policies and to which frequency Cuba changes between idealism and pragmatism, though most of the period have elements of both.

Since the victory of the Revolution in 1959 there has been eight cycles, the first of them is divided into three sub-cycles; four of them were idealist, while three were pragmatic and one of stagnation:

1. 1959-1966, This first period was an idealist cycle divided into three: “Erosion of the Market”, "Orthodox Soviet centralized planning model”, and “The debate between two Socialist alternatives (idealistic and pragmatic).
2. 1966-1970, Was the strongest idealist cycle where the adoption and radicalization by Fidel Castro’s Guevarista model took place.
5. 1991-1995, “Crisis, reforms and market”, the second pragmatic cycle, and the strongest so far, under the “special period in times of peace”.
7. 2003-2006 The “reversal of the reformation”, the fourth idealist cycle, but in diminished form.
8. 2007 and onwards, structural reforms of Raúl, the third pragmatic cycle and the strongest of the revolution.112

The policies addressed under each cycle were a) the collectivization of the means of production; b) centralization of economic policies and decision making; c) the role of the state budget; d) Foreign investment; e) assignment of rationing of goods versus market prices; f) free agricultural markets; g) Jobs in the private sector; h) voluntary work and labor mobilization; i) egalitarianism; j) moral incentives versus material incentives, and k) expansion of free social services. The idealist cycles were characterized by an increase in collectivization and centralization of decision making, a suspension or loss of importance of the state budget, the closing or decrease of foreign direct investment, a predominance of rationing over market prices, a non-existent or heavily restricted free agricultural market and self-employment sector, a labor mobilization and the use of “voluntary” workforce, the

111 Ibid. P. 24
112 Ibid. P. 25
promotion of egalitarianism and the substitution of material and economic incentives with moral ones, and the expansion of free social services. In the pragmatic cycles, just the opposite happens, but the degree of commitment to the changes depends on the cycle. What occurs is the de-collectivization, decentralization of decision making, a greater role of the state budget and fiscal balance, the opening and increase of foreign direct investment, an increased use of market prices on goods over rationing, an introduction or extension of free agricultural markets and self-employment, a reduction or elimination of mobilization of voluntary labor, a decrease of egalitarianism and an increase on material incentives, and cuts or restrictions on free social services. While keeping these cycles in mind, let us address the historical development of Cuba under the leadership of Fidel and his revolutionaries, focusing on economy and especially the FDI sector and analysis in chapter 5.

I will dedicate a longer explanation of the first cycle as it was here the established Cuban institutional system was founded, and would be the basis for latter cycles. During the first idealist cycle, four basic trends became clear by Fidel´s second year in power: 1) the nationalization of the economy, 2) a sharp turn to the Soviet bloc, 3) the establishment of an authoritarian regime, and 4) the launching of an egalitarian socioeconomic policy. When the U.S-owned refineries in Cuba refused to process the crude oil Cuba bought from Russia, Fidel expropriated all U.S oil companies’ activity on the island, and in retaliation, President Eisenhower suspended the Cuban sugar quota in the United States. The Cuban government responded by seizing virtually all the rest of U.S property and investments, and Washington reacted by embargoing all trade to Cuba, except medicine and foodstuffs. As Farber puts it; the social and political project that had taken place was fundamentally incompatible with the interests of the United States and of Cuba´s propertied classes. The radicalizing process of measures and countermeasures between USA and Cuba was no surprise. Any attempt at economic transformation when U.S companies dominated Cuba was bound to engender conflict. The incapacity of political revolutionaries to institute partial changes in the face of internal and external opposition led to a major confrontation with the U.S and eventual nationalization of all alien enterprises. This stripped Cuba from all forms of commitment and positive reputation as a trade partner, though ideologically they enjoyed support from different camps in the world.

113 Ibid. P. 25-26
114 Skidmore and Smith, Modern Latin America. P. 311
115 Farber, The Origins of the Cuban Revolution Reconsidered. P. 113
The swing to the Soviet bloc was neither a cause nor an effect of the clash with the United State; it was part and parcel of the same process, initially how far Soviet might be willing to commit themselves in Cuba, and the Russians did not disappoint. Fidel now had an alternative source of technology and equipment, and the Soviets were getting ready to integrate Cuba as a socialist ally in the Third World. By the end of 1960, Cuba’s swing to the East was decisive.116 The U.S was now convinced that Fidel Castro was communist, even though Fidel had not announced Cuba’s total conversion to the Soviet brand of socialism.

In the fall of 1960, Fidel moved to eliminate or neutralize the key institutions of the former “bourgeois” order which had been made to maintain status quo, and by December even the press was under Fidel’s control. He gained power to appoint new judges at will, and the universities and unions were also brought under absolute control. All private clubs and associations were subordinated to government direction. In the end, the only political party to survive the revolutionary transition was the Communist Party. Castro’s own ruling Communist party was fully established in 1965, when virtually all the major social and economic changes to Cuban society had already been carried out under his personal leadership and control.117 The development would later collide with what FDI theory claims to be the proper institutional framework for FDI to thrive in.

The revolutionaries were determined to attack the legacy of the corrupt, capitalist Cuba: illiteracy, disease, malnutrition, and dilapidated housing. As the direction of the revolution became apparent, the rich began to flee. The government would distribute the refugee’s abandoned assets, homes, offices and farms.118 This would, as we shall see, affect the country’s level of credible commitment. Fidel and his clique in charge were leading Cuba toward communist totalitarianism. The failed U.S. invasion in the Bay of Pigs in 1961 marked a watershed in U.S-Cuban relations, and when Soviet installed intermediate-range rocket bases in Cuba the superpower confrontation reached a climax with Cuba as an aggressor. The missiles were withdrawn, to Fidel’s great disappointment. Still, he declared himself a Marxist-Leninist in December 1961, and continued to be the overwhelmingly dominant personality in the Revolution.119 Eventually, Castro’s radicalism overtook that of the Soviet Union, and the Cuban Communists. However, the Soviet Union was guided by tactical considerations influenced by a number of factors, including the existing state of relations with

---

116 Skidmore and Smith, Modern Latin America. P. 312
117 Farber, The Origins of the Cuban Revolution Reconsidered. P. 63
118 Skidmore and Smith, Modern Latin America. P. 313
119 Ibid. P. 315
Washington. Their policy cannot be explained in simple terms, and will not be further elaborated here as there is not enough space in the thesis. The cycles presented by Mesa-Lago show that Castro was not an idealist, he was very much a pragmatic, considering his opportunities and outcomes as he balanced policy between ideology and pragmatism.

Eventually the revolutionaries could concentrate on the economic tasks facing the new Cuba. Fidel Castro was, by his own admission, an economic illiterate. This would become clear in his inclination towards showcase projects under the idealist cycles. His ignorance also explains his stubborn resistance, particularly during the early years of the revolution, when the reality was that material resources were limited and that an inescapable need existed for strict investment and spending priorities. The Cuban economy revolved around exporting sugar, and mostly to the U.S, which was a humiliating dependence. Cuba also lacked the raw materials and expertise to rush into industrialization, as trade between Cuba and the U.S had ceased, and this forced Cuba to depend largely on the Soviets and the Eastern bloc for equipment. An important point is that directions were to come from highly centralized planning bureaucracies, modeled after Soviet and Czech patterns, which was an ineffective and expensive effort. The Soviets (in 1963) demanded that the Cubans had to slow down the industrialization drive, improve their planning and recognize their comparative advantage: sugar.

Under the second idealist cycle in 1966, Fidel endorsed a strong idealist period. Cuba would make a gigantic collective effort accompanied by moral incentives, and Fidel thus increased his own power as he took charge the central planning apparatus. After a considerable step-up commitment to social revolution abroad, Fidel pulled back from the Guevarist line as Che himself was killed by U.S trained Bolivian Ranger troops in Bolivia in 1967. He signaled a return to Soviet orthodoxy, and began to downplay the export of revolution. Fidel embraced the sugar and announced that in 1970 Cuba would break all records for sugar production where they would harvest 10 million tons, later known as the “Year of the Decisive Endeavor”. That Fidel had planned for outcomes 7 years ahead in time would be a clear indication that he had no intentions of leaving his position, or the newly socialist agenda he pledged his allegiance to. However, the harvest failed and was a heavy

---

120 Farber, The Origins of the Cuban Revolution Reconsidered. P 144
121 Ibid. P. 57
122 Skidmore and Smith, Modern Latin America. P. 315
123 Ibid. P. 316
psychological toll as everything was sacrificed to release labor for the cane-fields.\footnote{Ibid. P. 318} The Cuban leaders were going through a familiar dilemma of Communist regimes: How to reconcile Marxist idealism with a pragmatic economic policy.\footnote{Ibid. P. 316-317} Still, “el Comandante” was about to change policies again. The Cuban policy turned more pragmatic as there were to be new management and planning systems, and more use of profits as a basis for decision-making, the third cycle was of a pragmatic nature. The private sector was to be given a greater role in both agricultural and services, and there was to be greater economic interaction with the West. This economic policy was accompanied by a similar shift in institutional policy.

The Cuban policy turned more pragmatic as there were to be new management and planning systems, and more use of profits as a basis for decision-making, the third cycle was of a pragmatic nature. The private sector was to be given a greater role in both agricultural and services, and there was to be greater economic interaction with the West. This economic policy was accompanied by a similar shift in institutional policy.

The Communist Party was strengthened and the unions and other mass organizations were reorganized and given a greater role under state control. The central orthodoxy led to greater control over education and mass media. By 1971, the radical experimentation was over, and Cuba’s enormous economic and military dependence on the Soviets was being played out.\footnote{Ibid. P. 319}

The revolution institutionalized itself as the decades passed. There had been more than two decades to educate and train new generations in the commitment to an egalitarian, communitarian ideal, and they were also able to train their own technicians, with Soviet and Eastern-European help to replace those who fled the radicalizing regime. The economic dependence on the U.S.S.R resembled the former U.S dependency. The integration of trade with the Soviet bloc was close to what it had been with the U.S, but the Soviet comradeship did not produce direct ownership which had created such a nationalist backlash against U.S economic penetration before 1959.\footnote{Ibid. P. 320}

Cuban maneuverability came from having Soviet military and economic protection. The revolutionaries and the little Caribbean island did generate impressive results both domestically and internationally. Socialist Cuba managed to serve basic human needs such as wiping out illiteracy, introducing a comprehensive school system (with highly ideological teaching content), and providing basic health care. Cuba seemed to prosper and thrive under Soviet subsidies, and meeting basic human needs generated a lot of support for the Cuban regime.\footnote{Ibid. P. 320} Still, with few personnel with actual experience of governing, the Cuban policy became an Ad hoc policy, a general political direction in which Fidel wanted to go, not pursuing a precise long-term economic strategy with a previously determined specific goal. If
the Soviet socialism was not the socialism Fidel sought, it was at least an important guide to how to unite Marxist ideology with pragmatic economics, but as we shall see, the Soviet model was not ideal at all.

In 1986 Fidel launched the “rectification program” (Proceso de Rectificación de la Reforma) under the fourth idealist cycle, which abolished small-scale private business and reintroduced moral incentives, attempting to make a virtue of the country’s deepening economic crisis. This was precisely the opposite direction from the “perestroika” that was being launched in the Soviet Union.

4.1.2 Cuba in Transition

Cuba reached mid-1991, and the fifth pragmatic cycle, without the signs of mass discontent that doomed communism in Eastern-Europe. Still, several respected people from the army and air force defected to Florida. A key to the long survival of the Revolution was the ability to institutionalize the revolutionary process through the army, the militia, and the “Committees for the Defense of the Revolution”. The Communist Party was given a greater or lesser role at the initiative of Fidel and the top revolutionary leadership.\(^\text{129}\) The obvious means of extending the prerogatives of the Communist Party was to enhance control of society, reaching more people than existing institutions already were in touch with. Under the banner of “popular participation”, grass-root elections for regional assemblies were held, and this was according to Cuban government a much more democratic system that the one of the U.S, where only the richest would have the possibility to reach office.

By the mid 1990’s, Cubans were complaining about a highly centralized, bureaucratized and inefficient state apparatus.\(^\text{130}\) The Soviet bloc collapsed and with it COMECON (the foreign trade authority for the U.S.S.R and Eastern-Europe), which brutally exposed Cuba’s economic vulnerability as the foreign underpinning of its economy vanished almost overnight. By 1992, all Russian economic and military aid was gone. The reason for the economic crisis that occurred was not hard to identify as Cuba had 85 % - 90 % of its foreign trade within the inefficient COMECON system. Cuba had failed to diversify its foreign commerce in the course of the past 35 years, despite that this had been a central goal

---

\(^\text{129}\) Ibid. P. 322
\(^\text{130}\) Ibid. P. 322
of the revolution. Cuba could not prevent the collapse or contain the damage from it.\textsuperscript{131} Oil shipments fell 86 percent from 1989 to 1992, and food imports dropped 42% in the same period. Vital replacement parts for buses and other mechanical devices were nowhere to be found, and general economic activity fell by at least 29% between 1989 and 1993. Cuba had suffered one of the greatest economic blows experienced in Latin America in the twentieth century.\textsuperscript{132} Few could foresee the downfall of the U.S.S.R, and Cuba had excessively concentrated its trade and finance with one market, about 84% alone with COMECON. The security in the Soviet connection gave little need to diversify its exports or its markets. Again, Cuba became the ultimate example of dependency.\textsuperscript{133}

Cuba entered “the special period in peace time” as Fidel declared it, and this cycle was to be definitively pragmatic, where Cubans experienced a drastic fall in living standards. Monthly rationing quotas now covered only one or two weeks, electricity could only be enjoyed 4-8 hours per day, and bus services virtually disappeared because of fuel shortages. Fidel now had to protect the island’s sovereignty as well as the socialism. In 1993, he declared that:

\begin{quote}
"Today we cannot speak of the pure, ideal, perfect socialism which we dream because life forces us into concession".\textsuperscript{134}
\end{quote}

Cuba was in need of hard currency, which led to the court of Western investment. The use of dollar was decriminalized, and in 1994 farmers was allowed to sell on the open market, while private taxis and family run restaurants (paladares) reappeared in the major cities. These enterprises were burdened through tough regulations and high taxes, as Fidel was determined to throttle the spread of capitalism as long as he could. Still, severe shortages and virtually zero investment (aside from tourism) plagued every sector of the economy, worsened by the U.S embargo and the lack of foreign exchange. Even though the laws could be ignored by most countries, the incentives to invest or do business with Cuba would in most cases not be worth the risk of facing dominant capital giant U.S. I will return to the history and effects of the embargo.

\textsuperscript{132} Skidmore and Smith, Modern Latin America. P. 323
\textsuperscript{133} Ibid. P. 323
\textsuperscript{134} Ibid. P. 323
In 1995, decree law 77 was enacted to pursue the goals of the economic austerity program. It set out specific guarantees for foreign firms by establishing full protection and security against expropriation and it opened all sectors of the Cuban economy (except public health, education and the military). Tourism became an essential source of hard currency, matched only by remittances from Cubans living abroad, and several joint ventures appeared in cooperation with European investors. The sharp contrast between tourists and locals set another tone to society. Were Cubans supposed to work for moral incentives while they observed the material goods, and heard stories of better lives from the tourists, and family members living abroad?

In 1997, the cycle of stagnation had begun as Fidel and his followers feared the de-collectivization, decentralization and the delegation of financial power with an increased independence to farmers, self-employed workers and other sectors that displayed the state as weak. An increase in employment rates and inequality was too far a stretch from the ideological guidelines. Still, on the fortieth anniversary of the revolution, in the cycle of stagnation, on January 1, 1999, Fidel reaffirmed his commitment to saving the country, revolution, and the conquest of socialism from the “new religion” of neoliberalism, which had turned the planet into a giant casino. Again he introduced restriction on private sector, but during the hard 90’s the flirting with capitalism had already made some balls rolling.

Venezuela became a substitution of the U.S.S.R as the big subsidizer of Cuban socialism and economy under the Chavez government. Between the years 2001-2007, Cuba received $4000 million U.S. worth of credit, investment and financial support from Venezuela. The accumulation of debt reached $2500 million U.S. for the importation of petroleum, which Cuba paid with 20 000 doctors, teachers and health personnel. Investors like Sherritt International from Canada and Meliá from Spain increased investment in mining and tourism. These positive economic trends gave Fidel the confidence to make some cuts in the strict reforms of the 90’s, which challenged his ideology. The trend of “thinking capitalism, but continue being socialists” became more adequate as the deep economic crisis of the 90’s left its mark in Cuban society and the leaders of the republic. The U.S embargo remained, but in 2001, it opened for selling foodstuff and medicines to Cuba.

A new idealist cycle was initiated between the years 2003 – 2006, but as the former cycle of the same character, it came out negative. The anti-market cycle of the mid 2000s may

---

136 Skidmore and Smith, *Modern Latin America*. P. 324-325
137 Mesa-Lago, *Cuba En La Era De Raúl Castro: Reformas Económico-Sociales Y Sus Efectos*. P. 47
have increased state control over the economy, but it lacked the idealistic character of previous idealist cycles. Raúl’s initiatives now represent a much-needed departure from previous ways of managing Cuban economy.\(^\text{138}\)

With Fidel’s ambiguous class commitment and the nature of populist politics, he became different things to different people, but in August 2006, at the end of the 7\(^{th}\) idealist cycle, Fidel transferred the power to his brother Raúl Castro. Due to the serious situation of Cuban economy, Raúl called for structural reformation and reached consensus in the government. He entered the 8\(^{th}\) cycle of structural reforms. In 2008, Raúl was declared “Presidente del Consejo de Estado y de Ministros” and confirmed the direction he was taking. From 2010, the reformation process accelerated further as he implemented, in a moderate form, approval of private initiatives and market mechanisms.\(^\text{139}\) For Raúl, it was clear that the failure of the idealist cycles would strengthen the support of the structural reforms. The frequent changes to economic ideology created opposite indications that led to instability and insecurity, and affected development as there never was time enough to consolidate with one policy and harvest any potential fruits it would carry.\(^\text{140}\)

### 4.1.3 Summary

The first 40 years, Cuba played its role as a symbolic piece in the Cold War, heavily subsidized by the U.S.S.R. At this time, it was not at all that bad being Cuban, and there were even people of ideological conviction that immigrated to the island. Still, Fidel Castro and his revolutionaries had to balance Marxist ideology with pragmatic economics, but had more leverage in this period than after the fall of the Soviet bloc. The first decades after the revolution were used to find an ideological stand and consolidate with it, maybe it was socialist or maybe a form of nationalism, but events pushed Fidel to declare it as Communism, as their comrades in the east. Still, Cuban socialism is considered a term of its own, by Cubans themselves and academics.\(^\text{141}\)

A number of policy shifts, as noted by Mesa-Lago and described above, have occurred since the beginning of the Revolution. In the post-Cold War period, the structural adjustments, in the wake of the Soviet demise, resulted in the enactment of limited capitalist-


\(^{139}\) Mesa-Lago, *Cuba En La Era De Raúl Castro: Reformas Económico-Sociales Y Sus Efectos*. P. 19

\(^{140}\) Ibid. P. 50

style reforms, subsequent retrenchment during an economic boom, and market-based reforms by Raúl in the midst of the global economic crisis and domestic financial problems. It was here the real foundation for FDI was established, and considered an important strategic economic means to attract the necessary capital for the Cuban political and economic system to survive. However, the political considerations have always contributed to determining the nature and scope of economic policymaking. Some objectives seem to have changed though, as “the defense of socialism” became “the defense of the achievements of socialism” as nationalism replaced Marxist-Leninism as the guiding principles of the revolution in 1992.

In research question 3, I asked “what are the Cuban political, economic and cultural contextual experiences, and how do they affect credible commitment and FDI?” In this chapter, we see policy shifts that affect Cuba’s credibility and reputation. If we go back to the theory North mentions that, “how to bind players over time?”, and the time it takes to establish a reputation, affect the nation’s credibility. However, Cuba has seldom let policy operate long enough to establish consistency or reputation, which again leads to a reputation of inconsistency. There are reasons to believe that the inconsistency of Cuban policies, going back and forward between idealist and pragmatic reforms, would appear less favorable for foreign investors, as there is no legal framework to control the authority’s decision to drastically change policy direction. These shifts of Cuban authorities are fair to consider of negative influence on the country’s credible commitment.

With the political, economic, societal and cultural context in mind, I will in the next chapter address, analyze and discuss the empirical data and material. The contextual framework facilitates the analysis and contributes to understand the data I have considered to be of most relevance to my case-study.
5 Empirical Findings and Analysis

In the previous chapter, we saw how the political and economic institutional framework of Cuba was established during the Cold War era, and during the sudden fall of the Soviet bloc. In this chapter, I will analyze the relevant Cuban institutions, their formal/informal rules and norms, and how they affect the level of credible commitment of Cuba, which again affects the inward flows of FDI. I have chosen to analyze the formal and informal parts of Cuba’s institutional framework that I find most precarious, based on the theory elaborated in chapter 2. This will make us able to categorize Cuba’s degree of credible commitment using Singh’s “degrees of commitment”, discussed in section 2.2.5, to measure if there is a correlation between degree of credible commitment and inward flows of FDI.

First, I will address the centrally planned and rigid system of the Cuban institutional framework leading to the MINCEX. Second, I will analyze the status of FDI on the Island, and the degree of economic freedom in which the FDI sector operates. Thirdly, I analyze how the “Special economic and development free trade zones” actually affect the country’s FDI sector and the policies behind it. Fourth, though this thesis mainly addresses internal elements that function as obstacles for foreign investors, I choose to add an external factor because of how it affects the country’s credible commitment: the U.S. embargo. In section 5.2, the main emphasis will be on the formal laws concerning FDI, in order to establish an understanding of the formal rules passed down by the Cuban government. The laws are accompanied by a set of informal norms, which are more difficult to detect and study, but still they have a significant effect on the execution of the laws. In 5.3, I will discuss the findings from the empirical material used partly in chapter 4 and 5, in the context of credible commitment and the effect of FDI.

5.1 Institutions

5.1.1 Centrally Planned Rigid System and the MINCEX

In the theory 2.2.1, I talked about that if you want to achieve a satisfying degree of safety and to have low cost enforcement of contracts in international trade, you have to have third party enforcement, which ultimately means polity or the state. You have to establish a political system that will create rules and laws and enforce them at low cost. In chapter 4, I mentioned
Cuba’s history with capitalism and democracy, and elaborated on events that contributed to forming the Cuban political system of today. How does Cuba play its part as “third party enforcement”, and is the political system efficient in creating necessary rules and laws in the institutions related to FDI?

As mentioned before, Cuba is constitutionally defined as a Marxist-Leninist social state guided by the principles of José Martí, and the political ideas of Marx, Engels and Lenin. The Communist Party of Cuba is, by constitutional right, the leading power of society, and of the state, which has the capability of setting national policy. Cuba considers itself a “people’s democracy” as opposed to the “liberal democracy” of Western States. The Cuban government claims that the nomination of candidates at neighborhood level is even more representative than the U.S model, still, Cuba is internationally considered to be undemocratic.

The executive power lies with the Cuban government, represented by the Council of State and the Council of Ministers. The Legislative power is exercised through the unicameral National Assembly of People’s Power, which is constituted as the maximum authority of the state. The judiciary branch is the “People’s Supreme Court”, which rule in constitutional matters and review final appeals from lower courts including all criminal, civil, administrative, labor law, and economic cases. Every province has a superior court; they decide which cases are able to pass to the Supreme Court. Since the final establishment of the Communist Party of Cuba in 1965, Cuba has been governed by a highly centralized system headed by the party. Fidel Castro has been the head of state, but he passed the power to his brother Raúl Castro in 2006. This made Raúl the first secretary of the Communist Party of Cuba, the President in the Council of State, and the President of the Council of Ministers. Raúl exercises control over all aspects of societal life through the Communist Party and its affiliated mass organizations, the government bureaucracy headed by the Council of State, and the state security apparatus. The CCP controls all government positions, including judicial offices. In theory, the different branches of government have separate and defined areas of authority; in practice, the executive retains clearly full control over all levels of power.

---

145 Watch, "Country Summary : Cuba." P. 1
“...organizar y dirigir la ejecución de las actividades políticas, económicas, culturales, científicas, sociales y de defensa acordadas por la Asamblea Nacional de Poder Popular...”

Along with several other responsibilities elaborated in the same article, Article 98 illustrates that, within this system, all channels leads to the top where Raúl has complete power.

The state may enforce rules and laws, but they are alone to do so, with absolute power to do as they see fit. Often, the Cuban government has changed the course of the country, accommodating to the circumstances. In section 4.1.1, I addressed the idealist and pragmatic cycles of Cuban politics. These cycles shows how easily the government changes course between market and anti-market reforms and policy, never really giving the policies enough time to be able to harvest from potential gains. Though the pragmatic cycles offer a higher possibility of economic gains, it also includes market reforms that imply that the government has to relinquish control, meaning loss of power.

According to the constitution, the economy is to be guided as follows:

“El Estado organiza, dirige y controla la actividad económica nacional conforme a un plan que garantice el desarrollo programado del país, a fin de fortalecer el sistema socialista, satisfacer cada vez mejor las necesidades materiales y culturales de la sociedad y los ciudadanos, promover el desenvolvimiento de la persona humana y de su dignidad, el avance y la seguridad del país…El Estado dirige y controla el comercio exterior.”

To invest in Cuba you have to go through the “Ministerio de Comercio Exterior e Inversión Extranjera” (MINCEX) institution, formerly known as the “The Ministry of Foreign Investment and Economic Cooperation” (MINVEC), founded when law 77 was created. Investors have to go through a tedious process to invest (see appendix 1). As mentioned in point 9 (Appendix 1), when reaching the 5th point in the process of approbation, two years may already have passed. The timespan was an important issue in law 77, and as we recall from the theory section 2.2.1 and 2.2.2, the enforcement of commitment is contingent upon the domestic institutions. When domestic institutions cannot successfully realize the commitments they will lose credibility. Although the law sets deadlines for approval to a certain level, it is generally understood that the investment process on Cuba is slow, costly

146 Justicia, "Constitucion De La Republica De Cuba." Article.98
147 Ibid. Article.16 & 18
148 IV, "Foreign Investment in Cuba: Prospects and Perils." P. 913
and less transparent than in other regions. The timespan of two years or more, with no clear
definition of the interests of Cuba in the business seeking to invest, will only leave the most
eager and dedicated investors interested. Even then it is not determined that they will obtain a
permission to invest or form a joint venture with the Cuban authorities. They spend long
periods without information, and once the decision has been made, reasons will not be
explained. The Cuban business partner actually has little power to decide, and ultimately the
final decision is made by the government. The evaluation of the contributions made by both
parties, for establishment of joint ventures and international economic association contracts, is
done by methods freely agreed upon by the investors, and its value can be determined by the
expert certifications issued by entities that have authorization from the Ministry of Finance
and Prices. In the case of companies of completely foreign capital, a certificate issued by
authorized national entities is always required.

In terms of the institutional design and with respect to consistency with the underlying
belief system in that society, the constitution in place must be self-sustaining. Cuba’s
constitution has a rather aggressive tone towards capitalism as a whole. In article 3 it states:

“El socialismo y el Sistema político y social revolucionario establecido en esta Constitución, probado
por años de heroica resistencia frente a las agresiones de todo tipo y la guerra económica de los
gobiernos de la potencia imperialista más poderosa que ha existido y habiendo demostrado su
capacidad de transformar el país y crear una sociedad enteramente nueva y justa, es irrevocable, y
Cuba no volverá jamás al capitalismo.”\textsuperscript{149}

5.1.2 The FDI Sector

In the previous chapter I addressed the historical experiences of the political and economic
management of the revolution, and the road towards Communism (or Cuban socialism),
through the idealist and pragmatic cycles of Mesa-Lago. In this section, I will address the
experiences Cuba had with FDI and how the FDI sector looks today. I will pay specific
attention to decree law 77 of 1995 and decree law 118 of 2014, as they were both supposed to
generate an inflow current of FDI, and rapid capital, sorely needed on the island.\textsuperscript{150} I will in
be using Paolo Spadoni’s newly released work on “Cuba’s Socialist Economy” to address the
status of Cuban FDI sector, together with the work of the CEEC on “La inversión Extranjera
y De la Unión Europea en Cuba”.\textsuperscript{151} To further explore the laws, beyond the official versions

\textsuperscript{149} Justicia, “Constitucion De La Republica De Cuba.” Article 3
\textsuperscript{150} Info Latam, “La Asamblea Nacional De Cuba Aprueba La Nueva Ley De Inversión Extranjera,” (2014).
\textsuperscript{151} Pavel Vidal Alejandro and Pérez, “La Inversión Extranjera Y De La Unión Europea En Cuba.”
published by “Gaceta Oficial”, I will use the articles of Matias F. Travieso-Diaz, Charles P. Trumbull,¹⁵² and Armando A. Musa.¹⁵³

In section 2.1.2, we established that there is no detailed, authoritative and universal legal definition of what constitutes foreign direct investment. That is why it is important to explore the definition within the host nation in which one wish to invest, instead of solely trusting the benchmark definition established by OECD. It is fair to assume that the OECD covers most of a host nation’s definition, and that most nations will be close to the definition.

In a case like Cuba, it would be considered wise to make sure.

In the “investment guide” that was created for foreign investors by the enactment of law 118 in 2014. The role of FDI is defined as followed:

“Como parte de la actualización del modelo económico cubano, la inversión extranjera en Cuba se orienta a la diversificación y ampliación de los mercados de exportación, el acceso a tecnologías de avanzada, la sustitución de importaciones, la obtención de financiamiento externo, la creación de nuevas fuentes de empleo, la captación de métodos gerenciales y la vinculación de la misma con el desarrollo de encadenamientos productivos, así como el cambio de la matriz energética del país mediante el aprovechamiento de fuentes renovables de energía.”¹⁵⁴

On this notion, it should be understood that foreign investment in Cuba is considered complementary to national investment of medium-long term economic and social development, as a part of the state-led strategy for development under a centrally planned system. This system generates a condition of highly selective and discretionary approval of projects, while reducing the degree of freedom in the business management.¹⁵⁵ This restrictive and selective operation may also become a relative advantage for investors abroad since it operates without significant competitors with greater possibilities for expansion. Today, Cuba has no laws on competition or antitrust, although price regulations are made in almost all economic sectors. When an investor has passed the initial process of approval, it is easier to expand into other sectors leveraging new business opportunities. Several companies are currently simultaneously operating in more than one sector, being subject to various kinds of contracts. These advantages companies have can be quite insecure, depending at all time on the policies defined by the Cuban government.¹⁵⁶

¹⁵² IV, “Foreign Investment in Cuba: Prospects and Perils.”
¹⁵⁴ Ministerio del Comercio Exterior y la Inversión Extranjera, ”Guía Del Inversionista,” (2014). P. 6
¹⁵⁵ Pavel Vidal Alejandro and Pérez, ”La Inversión Extranjera Y De La Unión Europea En Cuba.” P. 4
¹⁵⁶ Ibid. P. 4-5
During the period 1959-63, Fidel Castro expropriated the assets of foreign nationals, which led to the submittal of claims by the affected parties before their respective governments. In the U.S, the “Federal Settlement Commission” (FCSC) received demands from thousands of U.S. nationals whose properties in Cuba were confiscated. FCSC certified 5911 claims with a total value of $1.8 billion in 1960 dollars. Investment by other countries amounted to $350 million. Cuba strongly rejected foreign direct investment as a positive factor in economic development the thirty years that followed the revolutionary takeover in January 1959. Ideologically, in Che Guevarian faith, FDI was a mean to exploit “third world countries” and to control their economics and political sphere. Relations with the capitalist countries was modest as Cuba perceived them to be unfair and inadequate, compared to the preferential terms of trade and subsidized financing of economic projects offered by the Soviet Union.

FDI disappeared from Cuba for three decades, and there was close to zero foreign investment since the expropriations until the 1980’s (except subsidies from Soviet and trade with COMECON). The necessity of capital and the willingness to “think capitalism while staying socialist” resulted in a new attitude towards foreign investors, though keeping socialist goals ever important, and in some cases as a bias to criticize investments and end joint ventures, throwing out the foreign partner. Well before the fall of the Soviet bloc, an important law concerning foreign investment was enacted in Cuba. Decree law 50 of 1982 admitted and codified the juridical form of an economic association with foreign capital and allowed overseas firms to hold equity positions in Cuba. The legislation was designed for joint ventures and aimed at stimulating the tourism sector as a recipient of FDI inflows, but also a way of advertising the revolutionary ideas, and the “socialist Caribbean paradise”. Despite its existence, no convincing attempts to attract FDI were made throughout the 1980s, and by the end of 1989 only two joint ventures with foreign companies had been formed in Cuba. However, the law created the foundation for future laws.

As previously noted, when trade with the Soviet Union and COMECON collapsed, the response from the Cuban government was the implementation of “the Special Period in Time of Peace” in September of 1990. This economic austerity program consisted of a series of measures intended to conserve energy and raw materials, stimulate food production, expand markets for exports and imports, and accelerate the development of international tourism.

---

157 Musa, "Cat on a Hot Tin Roof: Tha Status of Current Foreign Investors in a Post-Transition Cuba.” P. 3
158 Spadoni, Cuba’s Socialist Economy Today : Navigating Challenges and Change. P. 83
159 Ibid. P. 83
What is important for this case is that with it came the first real opening for FDI to the island in the search for markets, technology, and financing that disappeared with the demise of the socialist bloc.\textsuperscript{160} Still, it was a cautious start during the worst years of the economic recession when only a handful of hotel and oil exploration joint ventures were formed in Cuba. In 1992, the Constitution was modified to recognize property rights of society and “Asociaciones Económicas con Capital Extranjero” (AECEs).\textsuperscript{161} Inflows of FDI increased after 1993 as Cuba’s economy began to show signs of a modest but constant recovery, and MINVEC was created in April 1994 to deal with the foreign investment and help investors by guiding them through the Cuban bureaucracy. Since then, several foreign companies entered the Cuban market, despite of the extraterritorial Helms-Burton law that I will address later in this chapter.

The biggest share of FDI arrived after law 77 was declared in 1995 where joint ventures (empresas mixtas), international economic associations (contratos de asociación económica internacional) and companies with only foreign capital (empresa de capital totalmente extranjero) were allowed to invest on the island, the first two referred to as IEAs (international economic associations). I will elaborate further on these types of investments under law 77. By 2009 there were 307 foreign businesses operating in Cuba, and most of them joint ventures or international economic associations (IEAs).\textsuperscript{162} Companies with entirely foreign capital have never surpassed 1 % of established investments on the island. By 2012, there were only 6 of them, 3 operating in the petroleum sector, 2 in maritime transportation, and 1 in financial activities. The investors were from Venezuela, Panama, Virgin Islands and the Antilles. Some special contracts have also been given (“Contrato de Administración Hotelera”, or “Hotel Management Contracts”) to the “Melía de España” chain of hotels.\textsuperscript{163} In figure 4, we observe the number of FDI in different types of businesses, which shows that IEAs has been the preferred type of business in front of hotel management contracts.

\textsuperscript{160} Ibid. P. 83
\textsuperscript{161} Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba." P. 3
\textsuperscript{162} Ibid. P. 5
\textsuperscript{163} Ibid. P. 5
The last twenty years, the policy of assimilation of investment and contracts has been far from stable. There was a certain “boom” of investments in the nineties due to the crisis, but from 2003, this projection changed radically as Fidel introduced his idealist cycle. In that year, Cuba took a much more selective policy towards investments, prioritizing only projects of great economic impact, and began to review the results of existing firms, liquidating those not meeting approved social and corporate goals, or those that did not honor the agreed export figures or those that had generated losses. Still, after more than a decade of uninterrupted growth, the number of international economic associations has fallen since 2002 as a result of Cuba’s increasing selectiveness toward FDI and its unwillingness to create a more attractive business environment. Politically and economically, this correlates with the idealist cycle and the process of recentralization of the Cuban economy introduced by Fidel Castro in 2003.

I consider the reintroduction of idealist policies as a countermeasure to the unforeseen effects of the mid 90s policies, through which transmission of power and capital may have leaked. Also, it confirms the instability and hasty changes of policy, which we elaborated through Mesa-Lago’s cycles in chapter 4. At this time, former MINVEC minister Marta Lomas announced that Cuba would be selective in future validation of foreign

---

164 Ibid. P. 5
165 Ibid. P. 5-6
166 Spadoni, *Cuba’s Socialist Economy Today: Navigating Challenges and Change*. P. 84
investors. The authorities primarily wanted to first be able to identify what kind of FDI Cuba need, and then choose who would be able to invest. In addition, the state would not allow investment that directly competed with the state, but only those who contributed to the development of Cuban companies.\footnote{IV, “Foreign Investment in Cuba: Prospects and Perils.” P. 921} Then again, in 2007 the minister declared that Cuba was not interested in having too many joint ventures on the island, only those that had a direct effect on economy and the strategic sectors such as energy, mining and tourism. What can be observed in the idealist cycle initiated in 2003, through figure 5 and 6, is the Cuban authority’s regaining control of one of the most capitalist experiments executed on the island. It is a “two steps forwards, one step back” strategy, where the Cuban government wishes to slow down the rate of development, and analyze results before they reinitiate an “improved” strategy towards FDI. This could be considered a form of “cherry picking”, where the state wanted to choose freely between relevant FDIs. Cuba remained interested in FDI proposals, but only in those that suited its development plans and came from major players. The Cuban government also have preferred partnerships with state-owned firms (especially for Venezuela, China, Brazil and other politically friendly nations) and with private investors relying on government financial assistance.\footnote{Spadoni, \textit{Cuba's Socialist Economy Today : Navigating Challenges and Change}. P. 87}

![Evolution of dissolved International Economic Associations](image)

\textit{Figure 5: Evolution of dissolved International Economic Associations}

In Figure 5 we observe a drastic increase of dissolved IEAs in 2003, before an equally drastic decrease after Raúl came to power. Figure 6 shows the number of IEAs in the period of 1990 until 2009. Looking at both models we see a correlation between total number of IEAs and the evolution of dissolved IEAs.

Figure 6: Number of total IEAs in Cuba 1990-2009

Source: Pavel Vidal Alejandro and Pérez, “La Inversión Extranjera y de la Unión Europea En Cuba”

In the process of dissolving FDIs, the Cuban government has kept the bigger investors a priority above the smaller, and medium sized companies. This remains a priority today as the bigger investments have managed to maintain the positive trend in average results of total FDI.

Raúl set a goal of increasing foreign investment in Cuba’s economy with the “lineamientos”, which reiterated the need for FDI and called for acceptance of projects according to broader criteria than those used until then. With the lineamientos, they would officially be looking for projects that would meet other goals such as job creation and increasing national production in strategic areas, rather than projects that would only bring capital, technology, or new markets. They also called for more rapid decisions on potential projects, consideration of business models other than “joint ventures”; and pursuit of investments from countries not active in Cuba. In March 2009, as a part of a wide cabinet reshuffle aimed at streamlining government administration, Raúl Castro merged the

---

Ibid. P. 7

Peters, “A Viewer’S Giude to Cuba’S Economic Reform.” P. 18

72
Ministries of Foreign Investment and Foreign Trade to from a new entity, the Ministry of Foreign Trade and Foreign Investment (MINEX). In December 2012, Raúl Castro announced to the National Assembly that Cuba had taken a measure aimed at “re-establishing the credibility of our economy” by ending its freeze of the bank accounts of certain foreign companies that do business in Cuba. Years earlier, the accounts had been frozen when the Cuban government faced a liquidity crisis and could not back the companies deposit with hard currency. This way the companies could not repatriate revenues and profits.¹⁷²

Figure 7: Annual FDI in Cuba, 1993-2011

Source: Paolo Spadoni “Cuba’s Socialist Economy Today” ¹⁷³

Figure 7 shows the annual FDI income in Cuba between 1993 and 2011, measured in U.S. dollars. Compared to the Dominican Republic, another state in the Caribbean basin, we observe that Cuba is far from the results of the D.R, although Cuba´s gross domestic product exceeds the GDP of the D.R (see figure 8).

¹⁷² Ibid. P. 19
¹⁷³ Spadoni, Cuba’s Socialist Economy Today : Navigating Challenges and Change. P. 91
These are the last registered numbers the World Bank operates with concerning Cuba. Compared to the Dominican Republic, Cuba’s annual income of FDI is considerably lower. The states are both Spanish speaking with close to 11 million inhabitants on both islands, but Cuba is double the size. The main difference is between political and economic system where the DR is a Unitary Presidential Republic, Cuba is a Marxist-Leninist single party state. However, according to the World Bank, DR’s Gross Domestic Product (GDP) is lower than Cuba’s. In 2012 the respective numbers (in US$ million) of Cuba’s GDP was $6,448.2, and DR $5,651.9. Still, the DR has over double the FDI of Cuba. This illustrates the condition of the FDI sector in Cuba, and the long road that lies ahead if they want to achieve the numbers they are aiming for.

By 2014, it may have appeared clear to which sector, and with which strategy, FDI will bring the most benefits for the Cuban state. I purposely say “benefit the Cuban state”, and not the “economy”, as the desired effect so far has appeared to be direct capital for the government and the state, rather than indirect spillovers to the people and society. However, since 2007, Raúl and his cabinet have formulated themselves wisely, and formally enacted rules and norms that comply with investors critique on the first experience with opening of the economy to FDI with the law of 1995. The new FDI law 118 also came with “the Portfolio of Foreign Investment Opportunities”, which suggests that the Cuban government has adopted a proactive posture and is clear as to where it wants to direct and promote...
investments. However, the legal framework is not enough. It is necessary to organize and adjust the entire environment for doing business on the island, which includes banking system, customs and the tax system, as well as telecommunication, domestic trade and the real estate market (private property rights). I will address these factors more thoroughly in the following section.

5.1.3 Economic Freedom

The economic freedom of a country is of great importance for foreign investors. The economic freedom contributes to enhancing the country’s credible commitment through the freedom of economic transactions, property rights, labor, business, investment and more. Policies that promote freedom, whether through improvements in the rule of law, the promotion of competition and openness, or suitable restraints on the size and economic reach of the government, in reality turn out to offer and advance practical solutions to a wide range of economic and social challenges that face societies. Cuba scores very low on the “Index of Economic Freedom” at a 177th place (see figure 9), only beaten by North Korea. This index is an annual guide published by “The Wall Street Journal and The Heritage Foundation”, which is an analytic think tank of Washington. The index covers 10 freedoms from property rights to entrepreneurship in 186 countries on a scale from 0 - 100. The economic freedom is measured based on 10 quantitative and qualitative factors, grouped into four broad categories, or pillars, of economic freedom.

1. Rule of Law (Property rights, freedom from corruption)
2. Limited Government (Fiscal freedom, government spending)
3. Regulatory Efficiency (Business freedom, labor freedom, monetary freedom)
4. Open Markets (Trade freedom, investment freedom, financial freedom)

Countries that score between 0-49,9 are considered repressed, 50-59,9 are mostly unfree, 60-69,9 are moderately free, 70-79,9 are mostly free and 80-100 are considered free. Cuba has a generally low score since 1995, ending up around 30 on the scale, but we have to

174 Omar Everleny Pérez Villanueva Rafael J. Betancourt, "Analysis of the Portfolio of Opportunities for Foreign Investment in Cuba,” From the Island 25 (2014). P. 1
take into consideration the difficulty of extracting precise data from the country. However, difficulties extracting data does not make the score higher, rather the opposite. Also, the index is neoliberally positioned, where free markets and society in a capitalist context gives top score. I think it fails to consider the governmental spending on education, health and social security in Cuba. Cuba is doomed to score low on this index because of its political regime, but the numbers can still tell us something about the signals such statistics give to foreign investors, and help us categorize the level of commitment and liberalization.

![Graph showing 2015 score comparisons](http://www.heritage.org/index)

**Figure 9: 2015 Score Comparisons**


Investors look for economic freedom, but they are perfectly aware it is not easily found in Cuba. Most investors would like to see a transformation of the economic model, but would be willing to take the risk of investing early and gain from the liberalization process. An important element of transformation of the economic model is based on the method of management of the economy. If the state wants to maintain power and control they will, at least, have to give state enterprises more control. The role of the market in resource allocation is almost never recognized, considering the elimination of monopolies, greater decentralization of foreign trade, and increased competition in the business sector.

The Cuban guidelines of the economic model specify that it will continue to give priority to the planning and not the market, without setting clear boundaries between the two and specifying the role that the market will have, or changes that will be made to economic
planning. Entrepreneurs’ perceptions so far are that central planning has increased rather than become more flexible.  

Ian Livingstone, London & Regional co-executive chairman, has a 500 million dollar investment plan with Cuban authorities to develop a luxury Cuban tourist resort. Livingstone warns other investors that:

“…if you are an investor focused on quarterly results and internal rates of return with immediate exits, Cuba might not be for you, rather, Cuba is for long-term investors with patient capital.”

The investment in Cuba mostly consists of joint ventures and “Special Hotel Contracts”, this way the state keeps a close control over investment on the island. As seen in the numbers presented by the “investment guide”, joint ventures dominate the FDI sector. Considering that the total amount of FDI income in figure 7 has been stable since 2011, the FDI was by 2013 scattered between the sectors noted in figure 10, and business modalities as seen in figure 11.

![Image of FDI per sector (2013)](source)

**Figure 10: FDI per Sector 2013**

Source: “Cartera de Oportunidades de Inversión Extranjera”

---

177 Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba." P. 37
This shows us that by 2013, the tourism sector was where most FDI went. Still, hotel management contracts were only the second most preferred type of business modality. The state has more control over investments through joint ventures, but tourism is also a great channel to retrieve direct capital, without it having any direct effects on society. The tourist leaves after having spent his or her money, but the tips left for Cuban workers have made the tourist sector extremely popular. Cuba experiences some unforeseen effects of tourism such as doctors, lawyers, teachers and highly educated parts of the population leaving their occupation to serve in the tourism sector. It is important for Cuba to maintain the most important recourse they have, namely their human capital. As noted in figure 12, the highly educated workforce is one of the absolute positives for foreign investors.

In Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba.", a set off interviews was conducted with the embassies of 15 different EU countries, regarding the experience of investing in Cuba by investors from the respective countries. Potential investors, that have visited the island to learn about investment possibilities and the domestic market, were also included. The survey interview structure presented large subject of areas of economic and institutional frameworks, that may benefit or affect FDI in Cuba with the possibility to include and comment on other aspects deemed appropriate. The different embassies were asked to conduct an assessment of the impact

---

78
(positive, negative or neutral), and indicate the degree of impact intensity on a scale of 0 to 3 or -3. Where one indicates little impact, two half- and three strong- impact (negative or positive).  

15 interviews is probably not enough to have any significant statistical value, but the results are interesting for this case as they are addressing the importance of how different elements are emphasized by foreign investors, and where they lack confidence in the host nation.

Figure 12: Elements considered important for investment environment by EU investors

Source: Pavel Vidal Alejandro and Pérez, "La inversión Extranjera y de la Unión Europea en Cuba."

The results show that the most attractive (positive) elements that Cuba can offer is personal safety, which is important for the investors that wish to move with their family to the island to follow up on their investments. Also, the possibility of expanding had a higher score than one might expect as the regime is quite strict about what, and where, investments are placed. Still, once the investor passes the approval process and receives authorization, it is relatively easy to expand towards other sectors. The competition in the internal market is relatively low and this is considered an advantage by some of the interviewees. On the other hand, the risk is that most of the remaining competition is larger state owned companies where the state does not wish any competition whatsoever, but is willing to merge into joint ventures to some extent.

Political stability and the low levels of competition were also positive elements, though questions about what kind of transfer will take place when Raúl signs off and who will take over affected the results moderately. If Cuba was to see a democratic transition, current

181 Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De la Unión Europea En Cuba." P. 20
182 Ibid.
investors may encounter individuals (with legal claims from the period of expropriations) with inventive grounds for taking legal action against them through multiple private lawsuits. Investors would take this risk into consideration when formulating business strategies in Cuba under the current government. Cuba’s human capital is also an important resource, perhaps one which remains to be exploited properly.

The tax regime, the system of national economic planning, and the conditions for export, did not have any imperative significance for the investors. Though they could be better, they did not appear too unattractive and thus find themselves in the “neutral” section of the table.

Under “limitations”, or “negatives”, in our table, we find more elements than anywhere else, as well as factors that investors find to be at an insufficient level. The main constraint on Cuba as a place for investment is the labor regime; this is the element that received the worst negative score. Most investors who are interested in the possibilities in Cuba are not willing to accept having no control over their labor resources, and systematically having to depend on a state employment agency. The cost of wages paid to the agency is generally high compared to the regional average (700 USD on average), also counting the “bonuses” the investors have to pay workers to enhance commitment and motivation as the state only gives 5% to the worker in local CUP.\textsuperscript{183}

The authorization procedure for new businesses was also a considerable minus for investors. The costs of establishment may be on the regional average, except for labor costs and other telecommunications that are much higher. Also, there is a long time lag in the pre-authorization of the investment negotiations, which may take up to ten years in extreme cases, and the foreign party has to make multiple trips and fund the design of the project proposals. The approval process of new businesses is very much considered a limitation, also due to lack of information and transparency.\textsuperscript{184}

We also reckon a major concern towards the financial sector with the second highest negative score, and macroeconomic stability. The obligation to operate through Cuban public banks remains a latent risk as financial imbalances at the government level will automatically be transferred to the accounts of investors by blocking transfers. Although Cuba has gradually fulfilled its debt obligations, in the perception of the investors, Cuba remains a country with very high financial risk.\textsuperscript{185}

\textsuperscript{183} Ibid. P. 21
\textsuperscript{184} Ibid. P. 22
\textsuperscript{185} Ibid. P. 22-23
The legal framework is of specific interest for our case, and was described as neutral or negative, and never a favorable element. The legislation is too open to different interpretations. The space left for discretionary decision making does not provide protection to investors, and on the other hand, the mechanisms for resolving conflicts and even national BITs (or APPRIs in Spanish “Acuerdos Bilaterales para la Promoción y Protección Recíproca de Inversiones), are considered insufficient. The feeling of little protection is closely related to what is considered an imbalance in the balance of power, given the state as a partner. Not only in terms of direct negotiations in a production contract or partnership, but also in every area of the environment. In general, foreign companies may face different conditions depending on which company is the Cuban counterpart and the subordinate body. Also, the negative perception of respect for property rights influence long lead times for the transfer of the amounts received upon liquidation or sale of the business, as well as the lock on transfers and dividends. In figure 13 we observe the low score Cuba operates with on the international arena compared to Vietnam, China, who also score quite low, all of them significantly under world average.

![Figure 13: Property freedom comparison](image)

*Source: The Heritage Foundation*  

---

186 Ibid. P 23  
187 Foundation, "Index of Economic Freedom".
According to article 14, 15, 16, 18 and 19 in the constitution, the property rights and handling of resources are to be treated as followed:

“En la República de Cuba rige el sistema de economía basado en la propiedad socialista de todo el pueblo sobre los medios fundamentales de producción y en la supresión de la explotación del hombre por el hombre... Son de propiedad estatal socialista de todo el pueblo las tierras que no pertenecen a los agricultores pequeños o cooperativas integradas por éstos, el subsuelo, las minas, los recursos naturales tanto vivos como no vivos dentro de la zona económica marítima de la República, los bosques, las aguas y las vías de comunicación... b) los centrales azucareros, las fábricas, los medios fundamentales de transporte, y cuantas empresas, bancos e instalaciones han sido nacionalizados y expropiados a los imperialistas, latifundistas y burgueses, así como las fábricas, empresas e instalaciones económicas y centros científicos, sociales, culturales y deportivos construidos, fomentados o adquiridos por el Estado... Estos bienes no pueden trasmitirse en propiedad a personas naturales o jurídicas, salvo los casos excepcionales en que la trasmisión parcial o total de algún objetivo económico se destine a los fines del desarrollo del país y no afecten los fundamentos políticos, sociales y económicos de Estado, previa aprobación del Consejo de Ministros o su Comité Ejecutivo... Las tierras de las cooperativas no pueden ser embargadas ni gravadas y su propiedad puede ser transferida a otras cooperativas o al Estado, por las causas y según el procedimiento establecido en la ley”

However, article 23 states that the state will recognize the property of joint ventures and other IEAs as long as they conform to the law, and the use and disposition of the property that belongs to the state is governed by the provision of the law and treaties. This shows a part of a rather well written and comprehensive legal framework, still open for interpretation, but as my study implies, it is not the formal rules and norms that provide challenges and obstacles for investment.

A positive element, not accounted for in the tables, is the fight against corruption. Corruption has manifested and institutionalized itself throughout the third world, and is now as a big part of “new” democracies as representative governments and other democratic functions. It is a bi-product of a naïve policy by the western, modern states that have been promoting neo liberal reforms without taking institutional theory into consideration. Raúl Castro has given corruption a priority with the creation of “Contraloría General de la República”, and an increase in supervision and control over public resources throughout the entire institutional framework. This effort still lacks the creation of a legislation that is required to undergo public bidding projects and supply contracts with state companies (that handles with FDI) and requires them to make the conditions of adjudication public. Policies to increase transparency to help in the fight against corruption are still on hold. The International Transparency index considers the reforms that Raúl initiated to have had a

188 Justicia, "Constitucion De La Republica De Cuba.” Article 14,15 & 19
positive effect on corruption. In 2014, Cuba was ranked as 63 out of 175,\textsuperscript{189} and scores just over world average on the statistics shown by “World Heritage Foundation/Wall Street Journal” (see figure 14), beating both Vietnam and China on this field since the middle of the first decade of 2000.

Since some of the economic reforms in 2011, Cuba has closed more joint ventures than it has opened. Unilever, an Anglo-Dutch consumer goods group, ended a 15-year joint venture after failing to resolve a dispute with the government over who would have the controlling interest.\textsuperscript{191} Imprisonments of British executives in British investment and trading firm Coral Capital Group Ltd, and Canadian businessman CY Tokmakjian on the basis of fraud and bribery, does not further strengthen the level of “credible commitment” or economic freedom. More than anything, it may contribute to fear of investing as Cuba previously were more likely to deport such suspects, but now show that they are willing to find executives criminally liable.\textsuperscript{192} Michel Villand, the founder of a chain of bakeries called Pain de Paris, stopped doing business with Cuba as government partners defrauded him by keeping two sets of books. They then offered a ridiculously low sum for his stake. The

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure14.png}
\caption{Freedom from corruption comparison}
\label{fig:freedomcorruption}
\end{figure}

\textit{Source: The Heritage Foundation}\textsuperscript{190}

\begin{footnotesize}
\textsuperscript{190} Foundation, "Index of Economic Freedom".
\textsuperscript{192} Ibid.
\end{footnotesize}
bakeries are now in the hands of the government. Small or medium sized foreign businesses seem to have little or no leverage when dealing with the state. While bigger companies like the Swiss food giant Nestle, Britain’s imperial Tobacco Group, Spain’s Meliá Hotels International, and Canada’s Sherrit International, have all prospered in joint ventures with Cuba.\(^\text{193}\)

### 5.1.4 Special Economic Free trade zones

Brazilian development bank BNDES has financed a new special economic trading zone, with an expansion built by the Brazilian construction company “Odebrecht SA”. Cuba has put a lot of effort and prestige into their “Mariel Special Development Zone” (ZEDM) outside Havana. It has a 700-meter dock for boats longer than 40 feet to access, and a terminal with annual capacity of between 850,000 and 1 million containers. ZEDM is so far the most advanced project in the Cuban economy, and is a would-be capitalist enclave in what is a staunchly socialist country.\(^\text{194}\) However, Mariel will have to compete with ports such as those in Panama and Kingston, and transshipment is a price-sensitive business. A further complication is that the embargo forbids ships entering U.S waters if they have berthed in Cuba over the past six months. The special development and economic zones are defined as:

> “...demarcated geographic areas contained within a country’s national boundaries where the rules of business are different from those that prevail in the national territory. These differential rules principally deal with investment conditions, international trade and customs, taxation, and the regulatory environment; whereby the zone is given a business environment that is intended to be more liberal from a policy perspective and more effective from an administrative perspective than that of the national territory.”\(^\text{195}\)

With ZEDM, Cuba let market mechanisms work for them to attract investors and capital to update and finance the Cuban Socialism. The investment guide, which I further elaborate in section 5.2.2, is organized by sectors in the economy. Because of ZEDM’s importance and priority, the first section in the investment guide is dedicated entirely to project proposals for the ZEDM. It encompasses 32 of the 95 projects presented in the guide. Five of projects were in agriculture and the food sector, fifteen in biotechnology/pharmaceutical sector, ten in the industrial sector and one solar panel farm to

---

\(^{193}\) Ibid.  
generate electricity for consumption in the ZEDM, and one to provide ancillary services for the biotechnology/pharmaceutical industries.  

The promotion of ZEDM is a favorable change, as it should present opportunities for domestic and foreign companies in an environment of low cost and simplification of administrative and customs formalities. The concept diverges from the old and non-productive commercial free zones, as it aims to develop high-tech projects that contribute to increasing sources of employment, exports and import substitution. The hope with the special development an economic zones, is to attract foreign capital not supported in tariff and tax exemptions, but in providing competitive infrastructure and logistics. Still, the labor regime and the lack of dynamism in the laws would give the impression of a Cuba not interested in more than the direct effect, which is capital, rather than the indirect effect of FDI through spillovers.

Even though many firms stand ready to invest in the Port of Mariel free zone project, the process is taking time. During the “XXXII Feria International de la Habana”, the Cuban government presented law 118’s “investors guide” to the island. The guide included material, characteristics and possibilities in the Mariel terminal, and in which sectors investment is desired. Still, investment in the establishment of an industrial park takes several years to provide a return on the investment: in good conditions, around 7-12 years. This means investors often want to locate to free zones where everything is in place. In a historically volatile region like Central America, foreign investors also want to see that domestic companies take risks and show commitment by investing in bricks and mortar. Investment by domestic entrepreneurs signals to foreign investors that returns are possible. The Cuban “free zone” is not for Cubans, which makes it difficult to achieve such a commitment from domestic actors, and if returns take 7-12 years, it would demand a further dedication to Cuba’s more pragmatic political cycles to eventually be able to harvest any gains from the project. The free-zone initiative is a positive measure, but it does look like an enclave economy where the capitalist project of market dynamics and functions are to work in its basic forms, while the regular Cuban is standing on the outside looking over the fence without the possibility to participate.

196 Rafael J. Betancourt, "Analysis of the Portfolio of Opportunities for Foreign Investment in Cuba." P. 4
197 Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba." P .35
199 Thomas Farole, "Special Economic Zones: Progress, Emerging Challenges, and Future Directions." P. 60
For investors, Cuban bureaucracy still creates obstacles for an effective introduction of FDI. Still, by June 2015, eighteen months after it opened, just six projects have been approved and authorized by the Council of Ministers. All projects but one, involves just a few million dollars, employing only dozens of workers. This is because of the lengthy process of developing a joint plan with one or more ministers, which can take months or even years. Formally, the zone has a 60-day approval timeframe, but it takes much longer to treat an application for investment into the economy (free-zone or not), and the process of permission can still last up to a year, without any promises of being granted. Foreign investors also complain about the strict labor system, where they have to hire workforce through the state-run labor company which pays the workforce low, causing the investors to having to stimulate workers “under the table” to create motivation. The strict supervision, the conflict resolution through Cuban entities, and having to be insured through Cuban state companies are all elements which make the free zone just as unattractive as the former investment environment on the island.

The potential investors visiting have still left little or nothing in the Port. Some are looking to set up shop in the next few years, but most await further evidence of a new Cuban attitude, and that the change in U.S. policy will lead to more progress in the contentious relationship. The Port is ready to boom if the U.S. embargo is lifted. It anchors the zone, with a competitive tax and customs regime. Still, it lacks infrastructure, development and a competitive edge in terms of property ownership, labor policy and the legal environment. As noted earlier, investors must go through a governmental hiring hall for labor, designed to “protect” Cubans from capitalist labor practices.

5.1.5 The Embargo

The Cuban embargo is known as the most comprehensive set of U.S. sanctions towards any country, including those states designated by the U.S. government as states that sponsor terrorism. In this thesis I mainly address the internal factors that complicate the current of FDI to the island. The embargo is an external factor, but its extensive effect and reach requires that it is at least mentioned. Therefore, I would like to give it a brief introduction and direct it towards actually economic damages it has inflicted upon Cuba, its credible commitment and flows of FDI.

---

200 Frank, “Cuba’S Free Trade Zone: A Would-Be Capitalist Enclave.”
The U.S. trade embargo against Cuba was imposed after Fidel Castro had nationalized all U.S. properties without compensation, and edged toward alliance with the Soviet Union. The embargo was designed to punish Cuba for the expropriations and to raise the cost to the Soviet Union of maintaining its new relationship with Cuba. Other governments in the “Organization of American States” (OAS) initially joined, in fear of Castro’s promise of guerilla warfare throughout the hemisphere to expand the social revolution. By the early 70’s, Castro’s attempt to export armed struggle had failed and he was under pressure from Moscow to change rhetoric and strategies towards other nations to avoid harming the Soviet relationship with Washington. In 1975, a meeting of Foreign Ministers in OAS voted for lifting the embargo, and from that point onwards it was up to each country to decide if they wanted to maintain diplomatic and trade relations with Cuba. Virtually all Latin American states resumed those relations, and no one supports the embargo. The U.S. was willing to go the same way but they had to be compensated for the expropriation of U.S. properties. Cuba recognized its obligation under international law to compensate the owners, but countered that it had claims of its own from damages incurred during the Bay of Pigs invasion and from the embargo. If the embargo was not lifted, Cuba claimed it would not have sufficient funds to pay the claims. It was informally agreed on that these issues would be negotiated. However, Cuba became involved in African conflicts, first in Angola, then in the conflict between Somalia and Ethiopia, which made the Carter administration add two more conditions for progress toward normalization: that Cuban troops to be removed from Africa, and that Havana show greater respect for human rights.

IN 1989, there were significant movements to meet in two of the conditions set by U.S, that could improve U.S. – Cuban relations. The U.S. and Soviet Union had made several international agreements, and Namibia became independent, South African troops withdrew from Namibia and Angola, and Cuba began a phased withdrawal from Angola. Cuba did not improve with respect to human rights though, and a significant number of political prisoners sat in Cuban jail.

When the Soviet Union fell in 1992, U.S. imposed conditions to begin a process of reconsolidation. Conditions seemed ideal to ease tensions and to begin a dialogue. However, the embargo was tightened through a Cuban Democracy Act signed into law, supported by

203 Ibid. P 534
President Bill Clinton. This was a move supposed to terminate the Castro regime within months, or as stated:

“…seek a peaceful transition to democracy and a resumption of economic growth in Cuba through the careful application of sanctions directed at the Castro government and support for the Cuban people.”

The law wanted to encourage other countries’ governments to restrict their trade and credit relations with Cuba, while trying to limit international cooperation by imposing sanctions on any country that provided assistance to Cuba. This did not generate the results planned, and Havana initiated a number of reforms in 1993, entering the “special period in times of peace”, which many Cubans consider the hardest years they ever lived under the revolution. The reforms opened for farmers markets and small private enterprises, the use of U.S. dollar as legal currency of payment and eventually more favorable terms for FDI. By 1995, Cuba was registered with a 2.5 percent growth rate, and by 1996, 7.6 percent. The Cuban Democracy Act was not an effective instrument for suffocating the Cuban economy and political system. At this stage, Cuba had come a long way toward complying with the U.S. conditions for engagement, but rather than responding positively the U.S. adopted new punitive measures. The incentives to comply with the U.S. demands grew more absent. The United Nations General Assembly has since 1992 had an overwhelming majority voting against the embargo. Israel, Panama, Uzbekistan, and some nations in need of U.S. protection or aid have voted for the embargo, or cast blank votes. The international community has denounced the U.S. embargo because it violates international law, and on moral, political and economic grounds.

In March 1996, the U.S. tightened its grip, once again by introducing the Helms-Burton Act that was signed into law. President Bill Clinton was initially against it and considered putting down a veto, but on February 24, 1996, Cuba shot down two small planes flown by Brothers to the Rescue (a Cuban-American organization) over the Straits of Florida in Cuban air space. The mood in the Congress turned ugly, the Helms Burton swept through, and Clinton signed the bill into law. The law violated international law and broke with U.S.

205 Smith, “Our Dysfunctional Cuban Embargo.” P. 535
206 Ibid. P. 537
goals of free trade and a more predictable world order. It aimed to multilateralize the embargo to the extent possible. It prohibited Cuban participation in international financial organizations, and threatened sanctions against countries that provided anything that could be defined as “economic assistance” to Cuba, also by attractive terms of trade. The Helms-Burton act imposed sanctions on third country nationals who would do business involving properties expropriated from U.S. nationals. The EU, Canada and Mexico all protested against the law and threatened to bring the U.S. to the WTO tribunal.207

What especially damaged Cuba’s opportunities to attract FDI, other than having a major conflict with the world’s only economic and military superpower, was that the law allowed U.S. nationals to sue foreign companies or other entities, including the Cuban government itself, in U.S. federal courts for “trafficking” in properties taken from them during the early days of the Revolution. This was highly controversial, as the U.S. does not have the right to bring the citizens of another country into the U.S. courts over properties lost in another country under international law. Also, the law locked U.S. policy in place indefinitely. The embargo was originally based on executive orders and could be modified or rescinded at the president’s discretion. Now, they became embedded in law. The lifting of the embargo and normalization of relations will have to be preceded by a repeal of the Helms Burton Act and ratified by the congress.208

The economic embargo from 1960 that broadened into what is today’s embargo consist of a set of economic, financial and commercial sanctions which rest principally on the following statutes and regulations:

- Trading With the Enemy Act of 1917, section 5(b)
- Foreign Assistance Act of 1961, section 620(a)
- Cuba Assets Control Regulations of 1963
- Cuban Democracy Act of 1992, the Torricelli Act
- Cuban Liberty and Democratic Solidarity Act of 1996, (Helms-Burton Act
- The Trade Sanctions Reform and Export Enhancement Act of 2000”209

Internationally, the U.S. embargo has not been taken into consideration by everyone, as many countries have continued investing into the Island. Investors admit that the embargo

207 Mesa-Lago, Cuba En La Era De Raúl Castro: Reformas Económico-Sociales Y Sus Efectos. P. 37
208 Smith, "Our Dysfunctional Cuban Embargo." P. 537-538
may complicate factors like transactions, papers for docking, entering or leaving territorial
grounds, but it is mainly internal elements of the Cuban economy that have the greatest effect
on the credibility of the island. As the U.N. generally assembly shows, there is a large
international agreement that the embargo is illegal and should be removed, which also creates
some safety for investors. It is doubtful that the U.S. would try to bring large Chinese,
Brazilian or EU investors to court for investing on Cuba, because it would damage U.S.
foreign relations. Ironically, by enacting the laws and maintaining the embargo, counter bills
have been enacted to create maneuverability in trade with Cuba, this principally through
lobbying from U.S. domestic industry. On the 111th Congress, convened on 6th of January
2009, there were five bills that promoted greater commercial and trade openness towards
Cuba: “

- **The Promoting American Agricultural and Medical Exports to Cuba Act of 2009,**
  reintroduced in the senate (S.1089) and House of Representatives (H.R. 1531) in
  2009. It was first introduced in 2007.

- **The Cuban reconciliation Act (H.R. 188)** which aims at lifting the trade embargo on
  Cuba and repealing the Cuban Democracy Act of 1992 and the Cuban Liberty and
  Democratic Solidarity (LIBERTAD) Act of 1996.

- **The United States-Cuba Trade Normalization Act of 2009 (H.R 2272)** which amends
  the Foreign Assistance Act of 1961 to lift the embargo on trade with Cuba.

- **The Free Trade with Cuba Act (H.R. 1530)**

- **The Freedom to Travel to Cuba Act introduced in the Senate (S.428) and House of
  Representatives (H.R. 874).”**

The UN Secretary-General has documented negative economic, social and cultural
impacts on the Cuban people due to the embargo. Cuba had by 2009 achieved three out of
eight Millennium Development Goals, and was close to achieving the five others. In spite of
Cuba’s achievement, the U.S. embargo has been a significant factor in hindering further
progress towards meeting the goals.

The Obama administration has taken necessary steps towards for lifting the embargo
with the reopening of embassies and reinitiating communication. This strategy is probably
preparing U.S. interests on the island towards the resignation of Raúl Castro in 2018. It would
appear that U.S. policies towards Cuba always end with the opposite effect of what was

---

210 Ibid. P. 12
initially intended, because Cuba enjoys respect and admiration throughout Latin America and within anti-U.S. circles all over the globe. Also, the fact that the Castro’s have been at the helm for half a century by now implies that policies have failed. On the other hand, there seems to be an internal embargo as well. If the embargo was lifted, the Cuban government would to a much greater degree be exposed to international law and obligations, and a considerable loss of power to individual freedom and entrepreneurship would be demanded from the international environment. Cuba would not be able to hide behind the necessities the embargo imposes on Cuban society. However, these are only speculations and I will not elaborate further on U.S. policies towards Cuba, the embargo, and future perspectives concerning this issue as it is not a part of this thesis. The important thing to remember is that it is an external factor that to a certain degree affects tan investor’s will to take chances in Cuba.

5.2 **Formal/informal rules and norms.**

In the previous chapter, I addressed the history and the factors of “Economy, politics, society and cultural heritage” on the left hand side of “table 1”, also to be found in the right hand bubble of figure 2. In this chapter, I will focus on “center/left” part of Figure 1, and the elements concerning formal/informal norms and rules within the institutions, and the effect on credible commitment and FDI.

As noted in table 1, I find that the State, with CCP and the MINCEX are the most important institutions as we investigate the effects on credible commitment and FDI. The formal norms and rules within this institutional framework are the centrally planned politics and economy, with market mechanisms existing only under the rules of special economic free zones. Additionally, Law 77, law 118, property rights and the constitution are the most important materialized formal rules concerning FDI. The informal part, that I will investigate, coexists with the formal rules and norms. They are much harder to observe and study, but we find them in informal constraints such as behavior, actions, commitment and rhetoric towards investors and the international investment society.

5.2.1 **Decree law 77 of 1995 - 2014**

The opening for foreign investment and international tourism led to an increased interest, but also growing complaints from foreign companies. Decree law 50 was limited for foreign
investors as they only could owe 49% of the share in a joint venture, and there was a low level of investment protection. According to Article 24 in Decree law 50 of 1982, if Cuba unilaterally terminated the activities of a joint venture, the Cuban National Bank guaranteed to foreign investors only the ability to repatriate the proceeds of their share after liquidation.211

In 1995, decree law 77 was enacted to pursue the goals of the economic austerity program. It set out specific guarantees for foreign firms by establishing full protection and security against expropriation and it opened all sectors of the Cuban economy (except public health, education and the military). It also abolished the limit of 49% of foreign shares for joint ventures and authorized the possibility of 100% foreign-owned investments, and topped it by introducing an attempt to speed up the process of authorization. The law required that approval or denial of an investment must be given within sixty days of the presentation of the formal request.212 As Cuban officials actively promoted investment on the island through visits to other countries, participation in international investment events, and meetings with potential investors, the international associations grew and expanded to different sectors of the Cuban economy such as mining, construction, light and food industries, agriculture and services other than tourism.

Law 77 of 1995 apparently offered, for the first time, substantial guarantees for investors:

“Las inversiones extranjeras dentro del territorio nacional no pueden ser expropiadas, salvo que esa acción se execute por motivos de utilidad pública o interés social declarados por el gobierno, previa indemnización en moneda libremente convertible por su valor comercial establecido de mutuo acuerdo.” 213

“Se garantiza la libre transferencia de beneficios al exterior, así como las cantidades derivadas de la expropiación, liquidación o venta de las participaciones en el negocio, sin pago de impuesto o ninguna otra exacción relacionada con dicha transferencia.” 214

“Se otorgan incentivos tributarios a las empresas mixtas y a las partes en los contratos de asociación económica internacional: exención del impuesto sobre los ingresos personales y menores tipos impositivos para el impuesto sobre utilidades, el impuesto por la utilización de la fuerza de trabajo y la contribución a la seguridad social.” 215

211 Spadoni, Cuba’s Socialist Economy Today: Navigating Challenges and Change. P. 85
212 Ibid. P. 85-86
214 Ibid. Chapter 3, article 8.
215 Ibid. Chapter 12, article 39
Also, Cuba signed 62 BITs which guarantee that the firms from a country within the treaty does not suffer from conditions less favorable than others, and offers a system of arbitration for the resolution of conflicts, with resolution deadlines. Cuba has also signed 11 agreements to avoid double taxation (Convenios para evitar la Doble Imposición y la Evasión Fiscal) (see appendix).\(^{216}\)

In law 77, there were no great restrictions written, and it opened practically every sector for investment without any limits on foreign capital. But in practice, the characteristics of Cuban institutional environment (an economy with high prevalence of state property, centrally planned, and poorly developed market relations) conditioned the possibilities of foreign investment, restricting it to certain sectors or forms of investment in terms of the public interest at each particular time.\(^{217}\) As mentioned, the law allowed companies to be entirely owned by companies of foreign capital. Still, a strong tendency of maintaining favorable ratios for the Cuban side in the structure of capital, preserving in almost all cases more than 50% in Cuban hands. This rule resulted in the reduction of partners in favor of greater use of resources or external debt, thereby increasing leverage levels in companies. The most concerning issue for a foreign investor who have less than 50% of capital, is lower control over business decisions, and the effect it has on the autonomy of the company as a whole.\(^{218}\)

The joint venture was the preferred business type of investment by the Cuban government, even though international economic associations and companies with entirely foreign capital were allowed. However, all modalities of FDI in Cuba could potentially be subject to adverse action following a political transition as seen in the idealist and pragmatic cycles. The joint venture is the type of investment most exposed to these kinds of transitions because the foreign investor often develops facilities or spends money directly in the country, and is therefore more vulnerable to unfavorable governmental, or private, action.\(^{219}\)

Law 77 also provided guarantees for property rights. Foreign investors had the right to sell or otherwise transmit their properties before the end of the authorization granted ended. The negotiation was commonly done with the state. Investors could also request an extension of time to operate in the country, which was provided if the proceedings were conducted before the end of the contract. The law guaranteed that the investment could not be

\(^{216}\) Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba." P. 4

\(^{217}\) Ibid. P. 4

\(^{218}\) Ibid. P. 13

\(^{219}\) Musa, "Cat on a Hot Tin Roof: Tha Status of Current Foreign Investors in a Post-Transition Cuba." P. 6
expropriated, except for legal or constitutionally qualified reasons, as a cause of public utility or social interest and with an establishment of compensation by mutual agreement.\textsuperscript{220} How the Cuban authorities measure the constitutionally qualified reasons is difficult and controversial, as it to a large degree leaves the Cuban government to decide how to interpret the law. The expropriation is considered to be a coercive transfer of private property to the state without there being any purchase. The purifying process of FDI on the island started in 2003´s idealist cycle, which resulted in the dissolution of at least 200 associations before 2009 (see figure 5 and 6). This was primarily based on the non-renewal of contracts that were to expire, or through negotiations culminating with sale of foreign property to the State. This clarification of the term “expropriation” is unable to relieve the investor´s uncertainty concerning the duration and stability of their business.

Reasons for why a contract is not renewed or canceled are almost never exposed and discussed with transparency, which investors have had a hard time understanding. Often, partnerships have been dissolved suddenly while showing prosperous results, showing the investor that Cuba assumes the foreign participation to be a temporary element, needed only in the initial stage of production development and market positioning. The Cuban government, on the other hand, claims the contracts have not fulfilled the agreed terms and fundamental objectives of the FDI on the island. There have also been reports of canceled contracts given the existence of conflict between the parties, arising, for example, before new regulations or conditions that the foreign part is unwilling to accept. The resolutions of conflicts between the parts in a partnership with foreign capital are settled abroad, while the conflicts that arose between a Cuban entity and a foreign partner were subjected to the Chambers of the Economy of the People´s Courts established by the Governing Council of the Supreme Court. This court would rarely favor the foreign side of a partnership.

According to the law, the state guarantees the foreign investor the free transference abroad, in freely convertible currency, without payment of taxes or any related duty in case of expropriation, liquidation, or sale of the business as well as net profits or dividends obtained by exploiting investment. Similarly, foreign workers that provide their services to these companies, and who are not permanent residents in Cuba, have the right to transfer the income they receive abroad, within the agreed amount, and complying with the regulation issued by Cuba´s Central Bank. However, in 2009, the impact of the 2008 financial crisis

\textsuperscript{220} Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba." P. 14
delayed the transfers from Cuban banks due to liquidity problems and the loss of the convertible Cuban peso convertibility.\textsuperscript{221}

On the access to financing, the legislation allow loans to be conducted with any state, mixed or foreign owned financial institution, within or outside the country. Still, it should be noted that no country in the European Union guarantees official credit safety lines to support investment in Cuba.\textsuperscript{222} The self-enforcing function of implementing, to some extent, liberal legislation varies. This shows that the informal side of the execution of law, cultural heritage and reputation has left financial institutions of the European Union to consider Cuba on a low level of credible commitment, even though the foreign investor enjoys a high level credible commitment, and a sound history of paying back loans.

As a rule, on the regulation of receipts and payments, foreign investment cannot use non-convertible currency (CUP) in their operations, so it is subject to the exchange rate regime of Cuban convertible peso (CUC). Law 77 states that businesses with foreign investment must use an account in freely convertible currency in any bank in the national banking system, to make receipts and payments related to their operations. While it is possible to open and use accounts in freely convertible currency in banks abroad, with the authorization of the Central Bank of Cuba, the most widely used instruments for payment are the irrevocable letter of credits, bills of exchange (with or without endorsement) and commercial invoices. A final consideration is the need to avoid the payment in USD currency and transit by a correspondent in the US, since the law of the US embargo would block payment.\textsuperscript{223}

The most important element, within the monetary paradigm, is the measures implemented to eliminate monetary duality. The Cuban state controls more than 75\% of the economy and most wages and local goods are priced in CUP, while the CUC is used in tourism, to price imports, and other business related sectors. The manner and speed in which the devaluation of the Cuban peso in the business sector is carried out and the impact of these actions will define the effects on inflation, the fiscal accounts, the balance sheets of companies and banks and FDI. The elimination of the dual currency would open new opportunities and participation in the domestic market for FDI, in addition to benefits from the outset reports on monetary and fiscal transparency. The restoration of full convertibility of the CUC, and possible devaluation against international currencies, may also be a central

\textsuperscript{221} Ibid. P. 15 
\textsuperscript{222} Ibid. P. 15 
\textsuperscript{223} Ibid. P. 15
element of the monetary tightening required with any direct and indirect impacts on FDI.  

Cuba is likely to eliminate its dual currency system soon, in a first step to simplifying multiple exchange system that investors have viewed as a serious obstacle to business. It would improve accounting transparency and the efficiency of state companies. However, as everything else on Cuba, it is a slow process which began already in October 2003, and the devaluation process will proceed cautiously and only in tandem with a strengthening economy. Also, a full unification and convertibility of the currency would typically require the backing of large hard currency reserves, often supported by the international Monetary Fund loans, but Cuba is not a member of the IMF. Cuba does not report its holdings of foreign currency, but the Economist Intelligence Unit estimates it has $11 billion of reserves against a forecast 2015 current account deficit of £524 million as of May 20. A real monetary reform would change the financial situation of state companies, improving competitiveness of the sector operating in the global economy and promote more transparency in financial accounts.

Perhaps the most debated obstacle for investment is the system of hiring labor. It is of a controversial sort and has been criticized by several investors. The hiring of labor cannot be done directly in Cuba, but through state employment agencies as ACOREC SA and Palco. This mechanism limits the selection of workers, the negotiation of wages and other terms of employment, as well as possibilities to make adjustment in the number of employed, which particularly affects the tourism sector given the high exposure to seasonal cycles. As mentioned in section 2.1.3, a restrictive labor regime has frequently affected the spillover effects negatively. Cuba’s restrictive and complicated system not only regulates wages to workers to maintain socialist goals, but it also contributes to lack of trust from both investors and employees. The great difference between what the foreign company agency pays for the employee and what the worker actually receives is unproportioned. The first transaction, which is between business and agency, is made in CUC, according to a standardized occupational category and type of business rates. The second transaction, between the agency and the worker, is performed in CUP, where the exchange rate is 1 CUC= 24 CUP. The wages that the agency pays workers represents less than 5% of what the foreign company actually paid for them, causing great demotivation for workers and requiring the foreign party to give additional bonuses directly depending on the results, this to avoid that employees steal from

---

224 Ibid. P. 38
225 Frank, "Cuba Likely to End Dual Currency System."
226 Ibid.
227 Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba." P. 19
the production or perform their duties poorly (which is the case in state sector). Table 2, is taken from Archibald R.M. Ritters “The Cuban Economy”, and gives a picture of what the hiring and payment of a Cuban worker costs on a monthly basis. The numbers are from 1995, but aside form a potential slight increase in prices, the table still is actual today.

Table 2: Monthly employment cost of Cuban workers in FDI companies (1995)

<table>
<thead>
<tr>
<th>Category</th>
<th>Basic Salary</th>
<th>Vacation Pay (9.09%)</th>
<th>Payroll Taxes (25%)</th>
<th>ACOREC Commission (10%)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manager</td>
<td>520.14</td>
<td>47.28</td>
<td>141.85</td>
<td>56.74</td>
<td>766.01</td>
</tr>
<tr>
<td>International sales</td>
<td>358.02</td>
<td>32.54</td>
<td>97.64</td>
<td>39.06</td>
<td>527.26</td>
</tr>
<tr>
<td>Sales assistant</td>
<td>259.39</td>
<td>23.58</td>
<td>76.74</td>
<td>28.30</td>
<td>382.01</td>
</tr>
<tr>
<td>Engineer</td>
<td>439.08</td>
<td>39.91</td>
<td>119.75</td>
<td>47.90</td>
<td>646.64</td>
</tr>
<tr>
<td>Executive secretary</td>
<td>231.00</td>
<td>20.99</td>
<td>62.99</td>
<td>25.19</td>
<td>340.17</td>
</tr>
<tr>
<td>Computer specialist</td>
<td>378.28</td>
<td>34.39</td>
<td>103.17</td>
<td>41.27</td>
<td>557.11</td>
</tr>
<tr>
<td>Automobile driver</td>
<td>143.00</td>
<td>12.99</td>
<td>36.99</td>
<td>15.59</td>
<td>210.57</td>
</tr>
</tbody>
</table>

Source: Information obtained from a 17 February 1995 bill sent by ACOREC, S.A., to the office of a foreign-invested company operating in Cuba, as reproduced in Fábregas i Cuillén (1998, 130).

As mentioned above, the labor regime is one of the main drawbacks for Cuba as a place for investment, as investors have no control of hiring workers, the wage costs are high and the workforce is demotivated. In the case of foreign workers, they need a work permit issued by the Ministry of Labor and Social Security, which should deal with the company that is hiring and be renewed annually, at a cost of course. The restrictive labor systems often generate poorer results from spillovers than liberalized systems. The Cuban case, however, is even more complicated, as it barely takes the theory of spillovers into consideration, but bets on the static goal of being able to extract as much capital as possible on each worker that works in a foreign company. The reason for this is ideological as it would deviate from socialist goals, and it would be considered highly unethical to let some lucky few earn up to 1000% or more than other citizens. It would, according to the Cuban government, create inequalities in the society that the revolution undertook to defeat, and break with early idealist goals.

thought that Cubans would work for moral rewards which would reflect his or hers higher level of political consciousness.  

5.2.2 Decree law 118 of 2014: same law, new wrapping

In 2014, Cuba declared its economy open (again) for business with a new foreign investment law as law 118 was enacted 29th of March, unanimously by the “National Assembly of People´s Power of Cuba”, together with other relevant legislation. The law is closely related to the “Guidelines for Economic and Social Policy” set by the Cuban government to promote sustainable development. In it, FDI is officially considered a source of economic development in the short, medium and long term perspective, as it will provide access to advanced technologies, management methods, diversification and expansion of exports markets, import substitution, external financing, new jobs and more income from productive linkages with domestic economies. This formally complies with what we elaborated on in the theory section on FDI and spillover effects. At the time of the enactment, there were around 200 joint ventures and other projects involving FDI on the island, compared with more than 400 just 12 years ago.

Law 118 embraces foreign capital as crucial to Cuba´s development. Cuba states that it needs $2-2.5 billion a year in FDI to reach the target of 7 percent growth a year, but economists estimate current FDI at a few hundred million, and a growth at just 2.2 percent in 2014. The law plays a part of the restructuration reforms enacted by Raúl, and is supposedly one of the more serious elements in the reforms. It appears to be a genuine attempt to join the global economy. However, Cuba´s past dealings with foreign investors suggest caution.

The law itself does not bring anything new to the table. The type of investment it seeks are joint ventures, International Economic Associations (including hotel administration, production or services, contracts for the provision of professional services, contracts at risk for exploration of non-renewable natural resources, for construction and agricultural production), and 100% foreign capital-owned businesses. This is much of the same as in law 77, but with some of the newer resolutions that have been developed between 1995 and

---

229 Skidmore and Smith, Modern Latin America. P. 316
230 Omar Everleny Pérez Villanueva / Rafael J. Betancourt, "Análisis De La Cartera De Oportunidades De Inversión Extranjera En Cuba," in Desde La Isla (Cuba: Cuba Study Group, 2014). P. 1
231 Trotta, "Cuba's Past Raises Skepticism About New Foreign Investment Law."
232 Extranjera, "Cartera De Oportunidades De Inversión Extranjera." P. 9
2014 incorporated. Law 118 is most notable for halving the tax on profits in half from 30% to 15%, and for eliminating labor tax while granting new investors an 8 year exemption on the profits tax of any industrial or other major investment project. By comparison, in the special development zone investors receive a 10-year reprieve from paying a 12% tax on profits and are exempted from the labor and income tax.

What is interesting with the law is that it came with an “investor’s guide to investment” (Cartera de Oportunidades) that is, according to MINCEX, an important tool to attract investors, while summarizing the interest of business developed by foreign capital and information on sectoral policies approved by the Cuban government. This document is a great insight into what the Cuban government seeks to achieve with FDI, though one should always have a critical mind towards statistics and data presented through governmental channels: there are few countries in the world that can predict the result of their state budget on the dollar like Cuba. The Minister of MINCEX, Rodrigo M. Diaz claims that the initiatives do not constitute a list developed by the government, but by Cuban enterprises, according to the government priorities. The companies again, are state owned and are complying with the government guidelines. I would rather say that it is the enterprise’s experience that forms the desired investment plans within the guidelines of the government. What is noteworthy is that only State-owned enterprises propose businesses, which practically means they seek for joint ventures. Despite the expressed will of the government to support and develop the non-state sector of the economy, there are no agricultural, industrial or service cooperatives. In reality, this means that the various national entities that are charged with implementing these decisions still do not align with the policies put forth by the leadership of the country.

Even though Cubans residing abroad are now allowed (to a certain degree) to invest, those residing in the country are excluded as potential investors (except for U.S. Cubans who are restricted by U.S. government and law). MINCEX claims that FDI is promoted in the need of foreign capital, which state-owned enterprises and Cuban residents do not have, to achieve the level of economic growth required. The law, however, does not distinguish between the sources of capital invested in the island. This selective approach emphasizes the experience and prestige of the foreign entities partnering with the Cubans. Still, as noted in section 2.1.4, some of the most important assets for export oriented FDI were skilled and productive labor, a

---

233 Frank, “Cuba Cuts Taxes for Foreign Investors.”
234 Rafael J. Betancourt, “Analysis of the Portfolio of Opportunities for Foreign Investment in Cuba.” P. 2
235 Ibid. P. 3
line of efficient suppliers, and competition in the domestic market with support institutions and services. When Cubans are excluded from investment, it is also difficult to achieve the level of services desired as the workforce lack experience with large investment projects. If Cuba wants to attract the mobile assets of FDI, they need to improve the quality of their immobile assets and create an unhostile investment environment, something that is hard to do with some of the restrictions put on labor and domestic investor’s possibility to participate and evolve.

Despite past failings, some investors and analysts believe the new law shows that Cuban authorities at the highest level agree that they need to attract more foreign investment, and that this marks a true change of course by a secretive government that has been in power since 1959. Thomas Herzfeld, of the Herzfeld Caribbean Basin Fund, believes it will be of value if the U.S. economic embargo ends. If that were to happen, investors will probably be encouraged to look at Cuba.236

5.3 Discussing FDI

So far, I have analyzed and elaborated on important elements which concern foreign investors. I will now discuss the top center, right and left factors of figure 2 and how these elements affect Cuba’s degree of credible commitment and inflow of FDI, I will especially connect it to the country’s degree of credible commitment.

In figure 1, we observed a rather pessimistic future perspective by the World Bank on Cuba’s economy. Cuba has decided on FDI as the development model for its economy. FDI is a popular measure for development in capitalist neoliberal theory, but countries like Vietnam and China who are both Communist have also opened their markets and economies to FDI. Countries that have kept the single party state have actually been quite successful. It is understandable that Cuba might look towards these countries when considering the possibilities to successfully implement FDI without losing control or power. However, attempts so far have led to less impressive results, as seen in figure 7. It could be worth considering that their regional context is quite different. China and Vietnam are located in what has been an authoritarian region, while Cuba is located in a democratic Latin America, with the USA as neighbor.

236 Trotta, "Cuba’s Past Raises Skepticism About New Foreign Investment Law."
Although the outcome of FDI has been heavily debated, the general understanding is that host nations need FDI to develop their economy, and that this happens mainly through spillovers. Given the theory we established in chapter 2, we should expect certain effects from FDI in the host nation. However, Cuba does not play the theoretical game to its fullest. The intention of keeping foreign ownership in Cuba at a minimum level has never been concealed by Cuban authorities. They have always said that FDI is a complementary tool to help strengthen and improve the country’s socialist system. New investment from abroad is based on strict consideration of what they can bring in terms of capital, technology, and markets. The Cuban government has been clear that it wants to preserve substantial control over the economy and the primacy of socialist property. We observe following trends in the empirical data presented in chapter 4 and 5:

I. Cuba’s attitude towards FDI has changed the last 20-25 years, in line with what the theory states about other LDCs. However, the Cuban government did not actually rethink their role, but the role FDI could have within the socialist system. There was a consensus that FDI would lead to a higher income of capital. The most important formal elements that prove this are the laws of 77 in 1995 and 118 in 2014. Still, there are many informal constraints in the institutional framework that makes the investment environment insecure.

II. According to figure 10, the biggest share of FDI invested in Cuba is found in joint ventures with state companies. The second biggest type of investment is the hotel management contracts. This leaves the state with full control and insight to the investments on the island.

III. As previously stated by Livingstone in this chapter: “if you are an investor focused on quarterly results and internal rates of return with immediate exits, Cuba might not be for you”, rather, Cuba is for long-term investors with patient capital”. The formal law may give safety to investors through promises of transfer or reinvestment of profits in freely convertible currency. However, actions like those of 2009, where foreign profit was frozen in the banks due to liquidity problems and the loss of the convertible Cuban peso convertibility, illustrate how easily these promises are broken. Also, several investors have experienced being shut down or thrown out because they, according to the Cuban government, have not delivered the results.

237 Spadoni, Cuba’s Socialist Economy Today: Navigating Challenges and Change. P. 84
agreed upon in initial contracts. Between the pragmatic and idealist cycles, the number of dissolved FDI and existing FDIs on the island varies greatly, as shown in figure 4 and 5. The juridical system seldom gives a verdict in favor of the foreign partner, and does not appear to be independent. Often, the foreign partner is not given any reason or explication for the takeover, or the Cuban government finds sufficient ideological reasons of contract breach within the legal framework, which is quite open for interpretation. Cuba has also showed that they are willing to incarcerate foreign company leaders on dubious grounds, rather than expelling them from the island.

IV. Cuba has developed their legal system. Since Raúl came to power, several projects and measures to attract more investment have been initiated, law 118 amongst them. Still, Cuba scores low on important issues such as property rights as seen in figure 13, only beaten by North Korea, which is an essential element for investors. The conditions for property rights to be ensured need an effective regulator, and neither these conditions, nor an independent regulator exist in Cuba. The formal legal framework appears to be friendly towards creating a better environment for FDI, but the execution and the interpretation of the laws vary too much. Processes such as the approbation for investment, is lengthy, and authorization sometimes comes all the way from the top before any decision is made. In chapter 4, we could observe the development of the Cuban institutional framework, and it does not appear to be a political system that creates rules and laws that can be enforced at low costs. Rather, they are Ad Hoc policies that the leaders sees fit or necessary to secure some elements of the system that is more important than economic and societal development, that does not comply with Cuban socialism.

V. When it comes down to the very essence of FDI effects on a host nation, it is the spillover that most economies hope to take full advantage of. However, in our Cuban case, it appears that Cuba has an extraordinary attitude towards the indirect effects of spillovers. In essence, they do not want them at all. By creating special development and economic free trade zones, they have the possibility to isolate the effects. Within these free zones, the Cuban government lets market mechanisms function as intended, which leaves Cuban economy with only the gains of capital. According to theory on FDI, the spillovers are supposed to develop society through wages, know-how, technology, management, and more. This should create competition, and stimulate
entrepreneurship in society. However, the issue is that this also leads to the citizens being strengthened in relation to the state, which the Cuban state does not want. Through the strict labor regime, the state has managed to avoid workers achieving greater economic and personal autonomy and freedom. Potential extra capital for workers to re-invest is in this way excluded as a possible effect, and taxation is also secured as the state takes 95% of the payment for each worker.

When it comes to the Cuban system, it is worth noting that the vertical hierarchy makes no, or little, room for competition. If the restructuration program (lineamientos), that Raúl initiated, is meant to create change within the institutional framework through the formal and informal rules and norms, the flawed incentive structure of the statist economic model is what makes it inefficient. As I established in theory section 2.2.3, all economic organizations are under state control, meaning that they almost operates as state institutions. If these “organizations” are the primary sources of institutional change, and the competition between them is the incentive to invest in skills and knowledge to enhance survival, then the vertical hierarchy of the Cuban state will take away the incentives. Rather a “minimum accomplishment culture” of what state regulation requires is observed. Their incentives are to execute tasks and orders from above to a satisfying degree. The horizontal pressure is close to zero and their position is safe. This also makes decision-making a lengthy process, as some decisions may have to be taken by Castro himself.

Except for taxes, little has changed in the new law, which means Cuban authorities´ attitude has not changed. Cuba´s approach to foreign business has been arbitrary. If a venture is successful, the government often wants a bigger stake. Foreign financing is welcomed, but once a project is operational the Cuban government wants to take charge. Cuban reforms seem to be moving at two different velocities: one very slow within the medium and large state companies, and one faster within the companies of smaller scale which tend to liberalize and transfer themselves to the non-state sector. This will create new opportunities for FDI, which may angle their investment towards liberalized rooms. Still, the undercapitalization and accumulated needs require a quicker pace, with agility in the decision-making process, which is an essential component in order for foreign capital to arrive as quickly as Cuban economy requires.

Law 118 from 2014 shares considerable elements with the old law 77 from 1995. If the former law was not successful, there are few reasons to believe that the new law will be. There been few formal problems with legislation on FDI. The problems are found in the
institutional framework surrounding them, and the credible commitment of those regulating the laws. Are the authorities now willing to take a higher risk than they did 20 years ago? As late as 2003, Fidel returned to an idealist policy to retain control over the economy and state after the first law and project on FDI. Even though law 118 is newer and modernized with better language, the framework surrounding it is still the same. The institutional, cultural, economic, societal frameworks we addressed in chapter 4 and 5 create the obstacles that prevent the laws from functioning as planned. However, the “investor`s guide” to investment on Cuba that came with law 118 suggests that the Cuban government has adopted a proactive posture, and is clear as to where it wants to direct and promote investments, which makes it is easier to stimulate the influx of foreign capital. The guide underscores large investments, largely excluding small and medium ventures, as if they were mutually exclusive (which they are not). Medium enterprises often tend to be more active in FDI than larger MNE, which have other interests associated with global value chains. This shows that the selectiveness of Cuba is pointed directly to investment that will generate a larger amount of capital, having direct effects on the economy, as desired by the government. This type of “cherry picking” could indicate that the Cuban authorities have misunderstood the effect FDI is supposed to have on the economy.

It seems like Cuba does not want spillover effects, and instead only wants those projects that directly provide capital for the Cuban economy. The theory states that spillovers create growth through local surplus, taxation of workers, entrepreneurship, innovation and more, but if the spillovers are left out, then the point is gone. It is a mismatch between formal written rules and statements from the Cuban government, and the actual actions of selecting FDI (mainly through establishing joint ventures). Receiving direct effects of FDI is interesting to most countries, but not the goal. The goal is for FDI to have indirect effects on the host economy so the domestic sector can evolve and generate more income to the state, in essence expanding the local economy. The legal framework is therefore not enough. It is necessary to organize the entire environment for doing business in the country through revising, not only formal norms and rules within the institutions that handles FDI, but also the informal part. Together, they make the investment environment that foreign investors analyze before involving themselves in any business, with or without state-owned firms. From a legal and economic viewpoint it appears that the various reforms made from 1995 – 2003 were of poor quality as the commitment of these rules and norms was low. As Investors initiated projects on the island, they experienced what could be referred to as a frustrating bureaucratic
nightmare. With law 118, investors will still face Cuba’s complicated approvals process, tough supervision, high communication costs and conflict resolution through state entities, unless stipulated otherwise in contracts, all of which could hold back the country’s possibilities for investment since the fall of the former Soviet Union.

As previously established, the impossibility of increasing state sector salaries and free hiring of labor makes productivity low, and the workforce suffers from “indiscipline” and “lack of interest in work”. From the theory, we recognize the informal constraints being crucial for efficiency. That the Cuban says “The state pretends to pay us, and we pretend to work” is an example of how informal constraints may affect elements as “labor” within the FDI paradigm. The ideological morality would claim that the Cuban workforce is undisciplined. I would say it is the observation of injustice, wealth amongst tourists, and information of how salaries and work are measured and valued in other countries, that negates the ideas of moral incentives. Most Cubans survive on some kind of informal economic trade after work hours, and some even during work, cutting three slices of meat, putting the fourth aside for own winning and survival.

An internationalized company often decides to concentrate production in a country that caters to a wider geographical area, where the country shows significant competitive advantages over other countries in the region in terms of labor costs, raw materials, tariff rates, infrastructural ports, logistics and other infrastructures. Cuba is not that country today; they have the challenge of building a suitable institutional, macro and micro environment that allows companies and their production to be internationally competitive. However, companies like Havana Club (rum, alcohol, culture) and Habanos SA (Cigars) have been smart enough to take advantage of the international prestige of the country in its respective areas. While others, like ALCATEL (telecommunication) has taken advantage of Cuba’s integration and membership in “Alianza Bolivariana para los Pueblos de Nuestra América” (ALBA).

238 Peters, "A Viewer’S Giude to Cuba’S Economic Reform." P. 8
5.3.1 Credible Commitment

Previously in this chapter, I analyzed some of the formal and informal rules and norms within the most important institutions that handle FDI. Moving down to credible commitment in figure 2, this section will see how Cuba’s credible commitment is affected by all of the above factors. I will also take into consideration other elements investors point out as important for them before considering investing.

As noted in the theory, the degree of commitment represents the variation of FDI that exists in a country. Both domestically and internationally, states can make commitments toward reformations. Most existing commitments at the international level often reflect the level of commitment domestically. The formal ways to conclude international commitments (highly valued commitments) is through the framework elaborated by WTO, the GATS (Uruguay round in 1986-1994), and through BITs with other countries. While according to North, the problem was “how to bind the players to agreements across space and time?”, the issue is not only solving a commitment problem, but also specifying the correct content to the commitment. In other words, what you are credibly committing to matters even more than whether you can commit to the policy rules required for reform.

Bilateral agreements and international treaties signed by Cuba have formally been kept throughout the revolution, but it is not these agreements that challenge Cuba’s credibility. It is the agreements made between investors and Cuba that often seem to be the focus of controversy as Cuba has tended to end cooperation, throwing the foreign investor out, when the business is up and running. However, the formal efforts made to provide assurances of legal protection to foreign investors should be taken to consideration. As mentioned earlier, Cuba has signed over 60 BITs with other countries. These are intended to protect and promote foreign investment focusing on the conditions for the approval of FDI, the treatment of foreign investors by the state, expropriation and resolution of disputes between the foreign investors and the host country. The BITs have been negotiated generally following the international norms and standards for such agreements. Still, it is not the quantity of engaged BITs that imposes the biggest impact on investors’ will to invest, but how the BITs are being upheld and executed. If the BITs were to improve the elements mentioned above, I will dare to say they have had little effect because approval of FDI is still a lengthy process.

Foreign investors have since the implementation of law 77 experienced state takeover and imprisonments, and experienced to be offered poor compensation for lost investment. The

---

239 Musa, “Cat on a Hot Tin Roof: Tha Status of Current Foreign Investors in a Post-Transition Cuba.” P. 7-8
possibility that Cuban state ends cooperation, throwing the investor out, is an important concern that foreign investors have. The Cuban state, on the other hand, say they fear investors will exploit Cuban resources without the investment being mutually beneficial. However, I find that even though Cuba has established that they will not sell their lands, and that all property is in the nation´s ownership, it is the fear of loss of control and power that generates the takeover or closedown of joint ventures and other FDIs.

The communist party adopted a comprehensive reform plan in 2011 that pledged to enhance Cuba´s credibility in its international economic relations by strictly observing all the commitments that have been entered into. The reform plan called for hastened rescheduling of Cuba´s foreign debt and flexible restructuring strategies for debt repayment. Cuba has restructured its debts with Russia, China, Japanese commercial creditors and Mexico as a prelude to more investment, and has made payments on time to suppliers and creditors. When French president Francois Hollande visited Cuba he told the companies in his delegation that Havana and the Cuba Working Group of the Paris Club of western creditor nations had reached agreement on the amount owed from a 1980s default. Cuba owes Paris Club members about 15 billion dollars in default debt, interest and service charges. France, Japan, Spain and Italy hold much of it. The Paris Club negotiations will be the first multinational attempt at restructuring in 15 years. It could also lead the way to settling old commercial debt held by the London Club and eventually to access to multilateral lending organizations if the US lifts opposition to Cuba´s membership. 240

The connection with credible commitment is clear: if the country does not pay its debts, why should any investor take the risk doing business. The repayments are a way of actually taking action to recompense for wrongful economic action towards former partners and investors. It is a sign of dedication to restructuring worth taking into account, and it could have an impact on Cuba´s credibility for foreign investors. Still, as noted in the theory, progressive social change, as the restructuring of Cuban economy, is not only about the shift in the rules. It is also about the content of those rules to limit the predatory proclivities of man, which are nowhere as dangerous as in the monopoly of coercion known as the state. In this case, the state and one man´s predatory proclivities is unanimous, making any promises or commitment volatile.

Cuba is juggling various initiatives and trying to play by established international rules as it seeks billions of dollars in investments. By trying to improve relations with the US;

240 Frank, “Cuba´S Free Trade Zone: A Would-Be Capitalist Enclave.”
negotiating to normalize relations with the EU; restructuring debts, Port of Mariel, tax incentives for investors; and expansions of a private sector and market forces, the level of credible commitment should also increase. However, from the theory of institutional change and credible commitment we have learned that; the informal rules and norms have as much, or more, effect on host nation’s credibility, as formal initiatives and changes. The improvement of laws and investment environment should be able to generate capital, but the restructuring should also be dynamic, moving towards greater property rights and a greater liberalization of politics and economy. If the time it takes to enhance reputation is not accompanied by credible commitment to rule of law and liberalization, Cuba may yet again turn towards a more idealist cycle, retracting reforms and maneuverability for investors. As I mentioned in the theory 2.2.1, the time it takes to establish a credible reputation is crucial. Time is important for the investors since the uncertainty about the ruler’s behavior can only be diminished by the ruler establishing a reputation and by learning on the part of the investors. The Cuban government likes to take its time and to consider every possible outcome of letting an investor enter to a certain sector with a certain project. It shows that keeping control and power is more important than increasing the reputation, and thereby Cuba’s credibility.

It does not hurt the island that ties with the U.S have re-emerged and embassies have been opened in both countries. Also, prominent state leaders (and the pope) as, the president of France, the foreign ministers of Japan, the Netherlands and Norway, the commerce secretary of Spain and EU’s foreign policy chief, Federica Mogherini, have all visited since the conversations started. These kinds of visits contribute to the strengthening of the credible commitment of the island, as it gives the process of liberalization and structural reforms political weight. Also, the visit of celebrities like Rhianna, Jay-Z, Beyoncé, Mick Jagger and other great artists helps improving the view of the island, maybe not directly for investors, but the perception of Cuba, and Cubans, affects investors through informal channels. Still, many government stalwarts are wary of the new U.S. approach after half a century of smear campaigns towards each other; the opening is like a Trojan horse for them. Others see the process as an opportunity for themselves, their families, and their country.

---

241 Ibid.
242 Ibid.
5.3.2 Foreign Frustration

The vision of the Cuban authorities concerning FDI is that it is not desirable that foreign investors transfer profit that is obtained in the domestic market abroad. Cuba wants foreign investors to channel external resources towards the island.\textsuperscript{244} From the perspective of the foreign investor, Cuba is a small market and a country with poorly developed production systems, in which almost everything needs to be done. However, Cuba currently imports much of its consumer goods. In the eyes of the investors, this means countless possibilities or market niches, which are the prime motives to engage in investment with the country.

The companies that want to invest in Cuba are not solely interested in only minority shares in joint ventures, which is mainly what Cuba offers. Cuba is proud of not having any foreign companies owning pieces of their country. It appears to be as much a nationalistic idealist problem as it is a communist-pragmatic problem. The state insists on having a majority stake in partnerships with foreign companies, but few companies want to give away a 51\% share and lose control. Investment is inefficient because of bad data and a workforce with little experience with big projects. Also, Cuba’s dual-currency system effectively functions as a tax in most sectors. The difficulty of finalizing details in agreements and lack of government clarity or changes they wish to impose, creates not only frustration among investors, but also a rumor which negatively affect the country’s reputation and thereby its credibility. Investors that have signed agreements years ago, still wait for projects to be realized, as the Cubans become unclear when details are being discussed.\textsuperscript{245} Similar obstacles arise in other sectors, and they all point to the same conclusion. The promise of closer diplomatic ties is exciting, but without an end to the embargo and a further liberalization of the Cuban economy, investors will wait, watch and prepare on the sideline while the world carefully approaches Cuba. As an investor puts it in “Financial Times:

“We are not like other places where all, not just some of, the rules are clear and standard across the board...Every deal will have to be negotiated”\textsuperscript{246}

While a foreign banker had a slightly more optimistic angle to Cuba saying that:

\textsuperscript{244} Pavel Vidal Alejandro and Pérez, “La Inversión Extranjera Y De La Unión Europea En Cuba.” P. 7
\textsuperscript{245} Marc Frank, “Cuba Struggles with Foreign Investment Growth,” Reuters (2012).
\textsuperscript{246} “Cuba’S New Port Offers a Small Opening to the Global Economy,” Financial Times (2013).
“Everything that has been going on here since Fidel Castro took ill has been a work in progress; including relations with the United States...Mariel is no exception. Only time and plenty of tweaking will tell if it is truly a success.”

Investors fear a reversal of the reform process and other counterproductive effects, like those observed within the idealist and pragmatic cycles. However, the opposite could happen, since it would be easier to advance reform at this stage than reverse them. It would also be easier to advance the reform having sufficient resources to establish the elimination of the dual currency, to create new capacities in institutions implementing change and to overcome the domestic financial crisis. Still, the state fear losing control and power, which affects the ongoing process of economic liberalization, where as we registered in figure 9, Cuba scores very low.

On the basis of my data, I have identified the main Cuban obstacles to be tied to the labor regime, authorization processes, legal framework, property rights and the state as a partner. Most of what I found relates to the CEEC report, elaborated upon in section 5.1.3, which confirms my analysis and my suspicion, that much of the formal legal framework is possible to work on or improve, while the informal constraints found in the institutional framework surrounding the laws, are not easily changed.

### 5.3.3 Concluding FDI

Taking everything into consideration, we now move to the last part of figure 2 from credible commitment to FDI. I will first return to Singh’s “degrees of commitment” from the theory chapter 2.2.5, with a comparative view. I would consider Cuba’s formal commitment during 1995-2006 to be a “reasonably strong commitment”. During this period, they actually did adopt some measures (like law 77) to open markets on various areas and sectors, two to four years after having committed themselves to GATS. Still, they retracted contracts and dissolved many of the joint ventures and FDIs in the early 2000s (see figure 7 and 8), as they yet again entered an idealist cycle. During this period, I will also consider liberalization on Cuba to be a “weak liberalization” because by 2006 it did have some foreign entry to the island by having passed down law 77, but it did not change the monopoly of the state considerably.

---

247 Ibid.
248 Pavel Vidal Alejandro and Pérez, "La Inversión Extranjera Y De La Unión Europea En Cuba." P. 35
During the period from the takeover of Raúl, and the initiation of the structural reforms, until today, Cuba has deepened their commitment towards foreign investors. Still, foreign investment is not pouring into the economy through the free trade zones, as the government had planned for. The reform plan from 2011 that pledged to enhance Cuba’s credibility in its international economic relations may have been the first significant action to enhance credibility. After that, the FDI law of 2014 was the next improvement of investment environment, but it offered few changes from the previous law from 1995. However, the fight against corruption has been a positive element for investors, which I have taken into consideration. Still, I would consider this period to be barely within the “reasonably strong commitment” with “weak” to “reasonably strong” liberalization, because the first significant measure took 4 years to present, and it took 3 more years to present law 118 and re-open all sectors for investment, except health, education and military.

This certainly seems like a positive categorization from my side, not shared by foreign investors who still thinks of the obstacles as too problematic, and would place Cuba under “weak commitment and liberalization”. However, this is exactly my point, because in order to evaluate countries like Cuba we have to look beyond Singh´s categorization. Even though Cuba has initiated reforms through formal rules and norms, the obstacles investors meet in the informal constraints in the execution of these laws, make Cuba’s credible commitment unsatisfying. Formally, my categorization can be accepted, but practically, Cuba still needs to convince the international society of their commitment. Also, the liberalization of the economy needs further depth beyond free trade zones, which are a debatable measure of liberalization.

My point is that Singh focuses on the formal side of the laws, but to understand the informal constraints you have to consider elements surrounding these laws. The formal side of law 77 and 118 looks legitimate, but when we study countries like Cuba we will be deluded by only addressing the formal side seeing the laws are both well written and well accounted for. The institutional framework surrounding the laws shows that the timeframe for authorizations are lengthy, the cost of labor is disproportionate in terms of payment to the state and compared to what the employee receive. Also, the way state manages business is controversial because they may suddenly abort the cooperation with investors. The authorities seek FDI and spillover effects, but do not want all of the effects to take place. These actions have more effect on credible commitment, and FDI, than the formal laws, which remains the same.
6 Conclusion: signs of change signs of continuity

In this thesis, I have argued that the lack of FDI inflow is due to obstacles in the formal and informal rules and norms in the institutional framework that handles FDI. The lack of credible commitment especially affects the inflow as the investors hesitate with investment due to lack of confidence.

I have analyzed the laws, rules, institutions, history and elements which all concern Cuba’s degree of openness and economic freedom, with a particular focus on FDI: in order to elaborate on how different factors affects the degree of FDI inflow to the island. We have seen that Cuba has a low degree of FDI (figure 7), which can be explained by the set of informal constraints that follow the formal rules and norms. I have also analyzed the most recent law of 2014, which formally does not appear to differ much from the law of 1995, which means they formally do not appear to be of a major obstacle for investors. However, the regime still is the same, and their interpretations of the laws, their actions towards foreign investors and their willingness to transmit power and control to other actors have remained mostly the same. I speculate that unless more profound changes occur in the political and administrative institutional sphere, the initiatives discussed in this thesis will not be further successful.

Are there any stories of the restructuring and reforming of societies that have not resulted in hardship and difficulties in the beginning before being able to prosper? Cuba will probably have to go through tough times before being able to harvest from reforms liberalizing the FDI sector and the economy as a whole. This includes the transmission of power from the Cuban authorities to other actors in the economy. Still, it seems like the government introduces reforms that help generate capital, while still retaining total control of society and economy. The idealist and pragmatic cycles of Mesa-Lago show the impatience of the Cuban leadership, who changes policy as soon as they observe some degree of loss of power and control. The structuration reforms of Raúl are some of the more liberal and committed reforms we have seen during the time of the Revolution, the question is if Cuban leaders are patient enough to go through a period of hardship before potential gains can be harvested? Mesa-Lago is skeptical to call these reforms “deeper or sufficiently profound” than earlier, in his conclusions:
My findings are compatible with those of Mesa-Lago in terms of the centralized system being ineffective in the promotion of FDI, and that the government struggles every time pragmatic decentralizing policies towards the market have been introduced. I find that there is a tension between how slowly things need to go given the government’s desire to retain control, and how fast they need given the precariousness of the economy. The Castro family has ruled through consensus, rather than through decree, and that takes time.

Still, Cuba will eventually undergo transition beyond the mere replacement of the Castro family as head of Cuban state. Some predict that after a short period of continuity meant to reassure Cubans and foreigners about the system’s stability, significant institutional changes in Cuban economic, social and political life will occur. Much has been written about the likely changes in Cuba; much less discussion has concerned the changes in the ideological and political landscape that are likely to accompany such institutional transformations. Any significant institutional change in Cuba will need to be supported and justified in political and ideological terms. In light of the strong pro-capitalist ideological tendencies that have developed in all post-communist transitions, and the existing tendencies in Cuban political thought that have been strengthened since the 1990s, we can expect the renewed formulation of certain positions regarding the background and early origins of the Cuban Revolution. Cuba’s geographical position and its proximity to the U.S constitute a potential for future currents of FDI. Should the U.S. embargo be removed and Cuba is able to attract major U.S players, it would strengthen the incentives to follow the rules of engagement, and demonstrate to others that investment is safe. Although Cuba has expropriated U.S property in the past, it is unlikely that they would repeat the deed as their terms for introduction of FDI has changed. If the Cuban government can have an inward flow of FDI on their premises, there will be no economic incentives to intervene, although moral incentives have proved to have a strong position in the Cuban politics.

The signs of change, we find in formal norms and rules generated through reforms are set to liberalize Cuban economy. However, we see continuity in how government executes the

---

250 Farber, *The Origins of the Cuban Revolution Reconsidered*. P. 171
laws, and treats foreign investors. Investors may have been given more liberties as Cuba has established free trade zones, but the obstacles investors have experienced earlier, and still observe, are deeply embedded in the international perception of FDI policies in Cuba. It is reasonable to presume that real institutional change and larger flows of inward FDI will take place first after the Castro family has retired, and a new generation has taken over.

Based on this case-study of Cuba, I have learned that the informal norms and constraints are of crucial importance for FDI to be successfully integrated into an economy. To the theory on FDI, I cannot contribute with more than what my results on the Cuban case reveals, which is “what is important for foreign investors when they seek to invest in Cuba”. Based on Singh’s theory, my findings would contribute to more emphasis on the informal elements of credible commitment and degree of liberalization. As we have seen above, the formal rules, norms and commitments may be of “reasonably strong” nature, but it does not cover the informal constraints that affect reputation and timid foreign investors. To North’s theory on institutions and credible commitment I do not bring much new to the field, but I confirm his theories and I apply them to a narrowed field which is the FDI sector in the Cuban economy. I think it will be of great use, for both investors and Cuban authorities, to apply institutional theory when facing the challenges ahead as Cuba enters a new political and economic era. Cuban authorities use an extensive amount of time to consider the best possible measures to take when improving state, economy and society. Further studies should investigate how institutional theory could help guide the cautious Cuban authorities towards liberalizing reforms, and how make the reforms more efficient.
Literature


———. "Uk Developer Plans to Invest $500m in Cuban Resort." Financial Times (2015).


———. "Cuba Frees Canadian Businessman Tokmakjian after Three Years in Jail." Reuters, 2015.


Appendix

Appendix I

“Para establecerse en Cuba con fines productivos, sea cual sea la modalidad pretendida, se deben seguir los siguientes pasos (www.cubaindustria.cu):

1. Identificar las empresas cubanas con posible interés en proyectos de inversión conjuntos con personas naturales o jurídicas extranjeras. Para ello es posible:
   • Contactar al Departamento de Promoción Comercial y Desarrollo Industrial perteneciente a la Cámara de Comercio de Cuba, responsable de promocionar la cartera de proyectos en los que existe interés de utilizar inversión extranjera.
   • Contratar los servicios de una consultoría radicada en Cuba
   • Contactar a los Ministerios y grupos empresariales correspondientes.

2. En caso de existir interés de desarrollar el proyecto de inversión, se subscribe una Carta de Intención de Negocios o Acuerdo Marco y se comienza el proceso de negociación.

3. Durante la negociación se prepara la documentación económica y jurídica que requiere la asociación propuesta, que en lo fundamental incluye: Proyecto de Convenio de Asociación y de Estatutos; y Estudio de Factibilidad Económica. Además el inversionista extranjero deberá presentar una acreditación de su identidad y solvencia, así como poderes que prueben su representación legítima en caso que concurra con el carácter de persona jurídica.

4. La documentación anterior será discutida con un representante del organismo patrocinador hasta obtener su aprobación.

5. Presentación de la documentación al Ministerio de Comercio Exterior e Inversión Extranjera (MINCEX), quien la somete en calidad de consulta a cuantos otros organismos e instituciones corresponda.

6. El MINCEX eleva la propuesta al Comité Ejecutivo del Consejo de Ministros (CECM) o a una comisión de gobierno designada por éste al efecto, para su aprobación o denegación. Dicha decisión no debe exceder los 60 días naturales contados a partir de la fecha de presentación de la solicitud.

7. Emisión de un Acuerdo o Resolución Gubernamental autorizando la creación de la Asociación. En la autorización se consignan las condiciones a que estará sometida ésta, el objetivo y el término de la forma de inversión de que se trate.

9. Inscripción en el Registro de Inversiones Extranjeras de la Cámara de Comercio. Para el registro inicial se establece un límite de 30 días a partir de la fecha de emisión del Acuerdo o Resolución Gubernamental a que se hace referencia en el punto siete. En el caso de una empresa de capital totalmente extranjero, también se debe contactar al Organismo Estatal rector de la rama de actividad que sea de interés y proseguir con el resto de las aprobaciones y pasos. En la práctica, el tiempo requerido en todo el proceso de negociación y aprobación es superior al de otros países y por tanto más costoso. Tan solo en las conversaciones iniciales (hasta el paso 5) pueden transcurrir alrededor de 2 años.”

Appendix II

<table>
<thead>
<tr>
<th>Date</th>
<th>Legislation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 13, 1993</td>
<td>Decree-Law 140</td>
<td>“Depenalization” of the possession of US dollars</td>
</tr>
<tr>
<td>September 8, 1993</td>
<td>Decree-Law 141</td>
<td>Liberalization of self-employment</td>
</tr>
<tr>
<td>September 1993</td>
<td>Decree 191</td>
<td>Re-establishment of agricultural markets</td>
</tr>
<tr>
<td>21 December 1994</td>
<td>Mining Law</td>
<td>Up-dating and modification of mining legislation</td>
</tr>
<tr>
<td>5 September 1995</td>
<td>Foreign Investment Law</td>
<td>Up-dating and liberalizing laws regarding direct foreign investment</td>
</tr>
<tr>
<td>21 October 1995</td>
<td>Decree 192</td>
<td>Establishment of artisanal and industrial product markets</td>
</tr>
<tr>
<td>3 June 1996</td>
<td>Decree-Law 165</td>
<td>Law on Export Processing Zones</td>
</tr>
<tr>
<td>15 May 1997</td>
<td>Decree-Law 172</td>
<td>Law on renting housing or rooms</td>
</tr>
</tbody>
</table>


251 Pavel Vidal Alejandro and Pérez, “La Inversión Extranjera Y De La Unión Europea En Cuba.” P. 44
Appendix III

Table 2  Economic Reform Measures under President Raul Castro, July 2006-October 2010

<table>
<thead>
<tr>
<th>Date</th>
<th>Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>Permission for Cuban citizens to use tourist hotel facilities</td>
</tr>
<tr>
<td></td>
<td>Permission to acquire personal cellular phone contracts</td>
</tr>
<tr>
<td></td>
<td>Permission to rent cars previously reserved for foreigners</td>
</tr>
<tr>
<td></td>
<td>Relaxation of rules regarding purchase of computers, DVD players, etc.</td>
</tr>
<tr>
<td></td>
<td>&quot;Resolution on Regulations for Labor Discipline&quot;</td>
</tr>
<tr>
<td>2007</td>
<td>Legalization of hard-currency salary supplements to Cuban employees of</td>
</tr>
<tr>
<td></td>
<td>foreign joint ventures</td>
</tr>
<tr>
<td>2008</td>
<td>Decree-Law No. 259, Long term leases of unused state land by small</td>
</tr>
<tr>
<td></td>
<td>farmers</td>
</tr>
<tr>
<td></td>
<td>Decree Law No. 260, Financial incentives to attract teachers back to</td>
</tr>
<tr>
<td></td>
<td>their profession</td>
</tr>
<tr>
<td>2009</td>
<td>Replacement of Fidel Castro’s economic team and resignation of the</td>
</tr>
<tr>
<td></td>
<td>President of the Central Bank</td>
</tr>
<tr>
<td></td>
<td>Proposal to reduce subsidization of rationed products</td>
</tr>
<tr>
<td>2010</td>
<td>Replacement of worker’s dining facilities with an income increase</td>
</tr>
<tr>
<td></td>
<td>Relaxation of restrictions on private taxis</td>
</tr>
<tr>
<td></td>
<td>Experiment with cooperative hair dressing salons and barber shops</td>
</tr>
<tr>
<td></td>
<td>Markets for inputs for small farmers</td>
</tr>
<tr>
<td></td>
<td>Raising of pension ages from 55 to 60 for women and from 60 to 65 for</td>
</tr>
<tr>
<td></td>
<td>men</td>
</tr>
<tr>
<td></td>
<td>Liberalization of sale of building materials to citizens</td>
</tr>
<tr>
<td></td>
<td>Legalization of 99-year leasing of land to foreign tourist companies</td>
</tr>
<tr>
<td></td>
<td>(Law-Decree 273, Articles 221 and 222.1 (August 13th))</td>
</tr>
<tr>
<td></td>
<td>Announcement of Lay-offs of 500,000 state sector workers to be</td>
</tr>
<tr>
<td></td>
<td>incorporated into self-employment and cooperatives. (September 13th)</td>
</tr>
<tr>
<td></td>
<td>Softening of some regulations for self-employment, plus a 40% tax on</td>
</tr>
<tr>
<td></td>
<td>gross revenues</td>
</tr>
</tbody>
</table>


Ibid.