RECOMENDED FEATURES OF A FOREIGN INVESTMENT CODE FOR CUBA'S FREE-MARKET TRANSITION

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INTRODUCTION

Foreign investment, and foreign direct investment in particular, has in recent times been the driving force behind the growth and restructuring of formerly sheltered economies, and has also served as a vehicle for the internationalization of many of the world's economies. Even though its economy remains under tight government controls, Cuba has recently joined the global trend towards encouraging foreign investment. Cuban officials, as well as students of Cuban affairs on the island and abroad, point to foreign investment as an important source of hard currency, and as one of the principal mechanisms on which the current government relies to stem the decline in the country's economy.

New laws, regulations and practices implemented in the last few years have succeeded in attracting some foreign investment into Cuba. Foreign investment in Cuba has bolstered certain economic sectors, particularly tourism, and has served to strengthen the island's economic relations with other countries. The impact of foreign investment in Cuba is, however, limited by the country's political and economic program, which restrains foreign investment in a number of significant respects.

As Cuba's transition to a free-market economy progresses, foreign investment will play an increasingly important role in the island's economic reconstruction. Cuba's laws affecting foreign investment will need to be updated as the transition unfolds in order to effectively regulate and foster foreign investment in the country.

This paper seeks to identify what should be the objectives of Cuba's foreign investment legislation during its transition to a free-market economy, and to describe the main features that such legislation should contain in order to maximize direct foreign investment in the island. Since foreign investment laws must be integrated with other economic development legislation, the paper also seeks to identify some of the key areas of interaction between foreign investment laws and other transition period legislation.

There is no "ideal" foreign investment code which could be copied for use in Cuba. Even if such legislation existed, it would probably be to a large extent inapplicable to Cuba due to the unique circumstances that will exist during the country's market transition. Certain features in the legislation, however, are recognized as creating an attractive climate for foreign investment. These favorable features have been analyzed by scholars and incorporated into general guidelines for investment legislation, such as the World Bank Guidelines on the Treatment of Foreign Direct Investment (hereinafter "World Bank Guidelines"). In addition, the successes and failures of countries making the transition from a command to a free-market economy provide insights into the probable results of particular elements of the foreign investment laws. These experiences need to be kept in mind for their potential applicability to Cuba.

The discussion in this paper reflects the above considerations. The second part describes the foreign investment legislation that is in place in Cuba today and summarizes its main shortcomings. The third part defines what the objectives of foreign investment legislation for Cuba should be in order to support the country's orderly transition to a free-market economy. The forth part draws upon the preceding ones to define the recommended features and requirements of foreign investment legislation for Cuba during its free-market transition. The fifth part discusses the relationship between Cuban foreign investment legislation and other transition period laws. Lastly, the sixth part provides some pertinent conclusions and recommendations.

FOREIGN INVESTMENT LEGISLATION IN CUBA TODAY

1. The 1982 foreign investment law: opening the door to foreign investment

After over twenty years of negligible foreign investment in Cuba, the Cuban government started to open the door to foreign entrepreneurs through Decree-Law No. 50 of February 15, 1982 ("Law 50"). This legislation allowed foreign investors to enter into joint ventures with state-owned enterprises in the development of specific projects, and authorized the repatriation of profits or dividends in convertible currency. The law, however, imposed many restrictions on investors. For example, it limited a foreign investor's share in a joint venture to 49%, although investors could negotiate operational control of the project.

The 1982 foreign investment law, not surprisingly, failed to attract much foreign investment to the island. Indeed, the first foreign investment project in Cuba since the Revolution was completed in 1990, eight years after Law 50 went into effect.

2. The post-1989 liberalization of foreign investment in Cuba

The year 1989 marked a watershed for the communist world: the iron curtain collapsed and the countries of the Soviet bloc started to make their transitions to democracy and free-market systems. That year also witnessed the beginning of the disintegration of the Soviet Union itself. The collapse of communism in Europe brought about a steep decline in the Cuban economy, which was dependent on favorable trade relations with the nations of the Soviet bloc. In addition, all economic aid from the former Soviet Union was suspended in 1992 and trade was dramatically curtailed. As a result of these developments, Cuba's economic output declined by 40% between 1989 and 1992. During that period, the country's exports declined by 70%, and imports dropped by 80%.

In response to the economic crisis, Cuba turned to foreign direct investment as the cornerstone of its strategy to lift the economy out of its depression. In order to attract such investment to the island, the government significantly liberalized its foreign investment practices. Amendments to the Cuban Constitution in 1992 eliminated some important restrictions on foreign investment. As amended, the Constitution permits property ownership by mixed enterprises and the transfer of state property to joint ventures with foreign capital.

These constitutional amendments enabled the institution of a more liberal foreign investment regime within the framework of Law 50. As set up after 1992, the foreign investment regime had the following salient features:

- Foreign ownership of up to 49% of an enterprise's shares. (In special cases, such as tourism, mining, and Latin-America based investments, foreigners were allowed to own 51% or more of an enterprise's shares.)
- Total exemption of taxes on gross income, personal income, and the transfer of real estate and business. The only taxes levied were 30% on profits and 25% on the payroll, to cover social security benefits for Cuban employees. Even those taxes could be waived or deferred at the discretion of the government.
- Elimination of customs duties for necessary imports of equipment and inputs.
- Unrestricted repatriation in hard currency of dividends, profits, and the salaries of foreign employees.
- Freedom in hiring foreign executives and technical personnel.

- State handling of the labor force, including disciplining of workers, a ban on strikes, and relatively low wages (to be paid in hard currency by the investor) for Cuban labor.
- State insurance covering lost profits due to accident, non-payment of merchandise, and non-fulfillment of terms of contracts due to political conditions.
- Availability of government support in areas such as legal, economic, accounting, and information services.

In addition to the general arrangements described above, the Cuban government sought to negotiate special deals in which foreign investment played an important role. Cuba also signed bilateral investment treaties (BITs) —agreements containing, inter alia, promises not to expropriate investors' property and to allow repatriation of investors' profits—with several countries, such as Britain, China, Colombia, Germany, Italy, Russia, and Spain. These guarantees are intended to provide further assurances to foreign venturers that their investment is secure.

3. Recent foreign investment experience in Cuba

The entire Cuban economy, with the exception of health care and education, was declared open to foreign investment in 1994. The main sectors where significant foreign investment has taken place include tourism, light industry, medical equipment and medicine production, mining, oil exploration, construction, and agro-industry.

Up to the present time, foreign investments in Cuba have been restricted to one of three types of business organization permitted under Cuban law:

- Joint ventures, in which a Cuban partner and a foreign partner invest jointly in a project. (This option includes management contracts, in which the foreign venturer provides the management skills to run the enterprise, and the Cuban partner provides all or most capital assets—an arrangement particularly common in the tourism industry.)
- Production agreements, in which Cuba supplies the labor and facilities and the foreign partner supplies equipment and materials, or provides advance credit. The foreign partner often becomes an exporter or distributor.
- Joint accounts, in which the foreign partner manufactures and distributes abroad products designed in Cuba, assuming the risks, but reaping the profits.

The most commonly used format has been the formation of joint ventures between the foreign party and a Cuban enterprise which is either an existing state instrumentality or a "private" SA formed by the Cuban government. Over 200 such ventures have been established in the last five years. While the foreign investor is generally not allowed to assume a majority interest in a joint venture, there have been a number of instances in which majority ownership by the foreign venturer was approved.

Despite the post-1989 liberalization of Cuban foreign investment law, foreign investors still have had to cope with an abundance of risks and red tape. One of the shortcomings of Law 50 was that the joint ventures it authorized between foreign investors and state entities required approval by a special commission of the Council of Ministers, which reviewed projects on a case by case basis. In addition, Cuban laws failed to provide explicit guarantees against expropriation, an important omission given the uncompensated expropriation of more than $2 billion worth of foreign-owned assets in 1959 and 1960. Foreign investors also had to contend with the possibility that the Cuban government might unilaterally terminate a venture—as apparently happened in one case—or that an enterprise could become subject to a restitution claim deriving from the expropriation of foreign assets after the 1959 revolution.

CUBA'S NEW FOREIGN INVESTMENT LAW

1. Introduction

As of the writing of this paper in August 1995, Cuba was reported to be ready to enact a new foreign investment law, which shall be referred herein as Law No. XX of 1995 ("Law XX"), which will replace Law 50. Predictably, Law XX does not represent a fresh start but follows an evolutionary approach to Cuba's foreign investment regime: the new law retains many of the provisions, and the generally restrictive investment climate, of Law 50. However, Law XX (in its current form, which may be modified when the law is finally passed) contains some significant improvements from the previous law, which may help liberalize the island's basic economic structure.

2. Major Similarities to Law 50

Law XX retains the basic structure of Law 50. The familiar forms of business organization in Law 50 (joint ventures, production agreements, and joint accounts) are retained in the new law, although Law XX includes one new important form of business organization, the "enterprise with entirely foreign capital." Such enterprises are described in the next subsection.

Approval of investments is still done on a case-by-case basis. A new entity, the Ministry of Foreign Investment and Economic Cooperation (MINVEC), is charged with supervising foreign investment activities, receiving foreign investment applications, and submitting them for approval to the Executive Committee of the Council of Ministers or a Commission appointed by that Committee. A decision on whether to approve an application must be reached within sixty days from the date of the application, and is not appealable.

The new law sets up a centralized system by granting MINVEC primary authority to process the investment applications. Nevertheless, the approval procedure is likely to remain onerous because authorization from other interested state entities will still be required. Other Cuban government institutions which have jurisdiction over foreign investments may be reluctant to relinquish their power and allow the establishment of a true centralized approval system. The result is likely to be a continuation of the cumbersome and unpredictable approval process now in place.

The provisions on profit repatriation remain basically the same. Since the new foreign investment law contains provisions (discussed below) that guarantee compensation in the event of expropriation and allow foreign investors to sell their shares in joint ventures, Law XX lists moneys received pursuant to those provisions among the authorized forms of profit repatriation. The new law also authorizes the repatriation in hard currency of any amounts received upon the winding up of the enterprise.

The new law generally retains Law 50's system of labor regulation for foreign investments. Enterprises with entirely foreign capital must still hire workers indirectly, that is, they must contract labor from a pool of Cuban workers designated by the state. As in the old law, foreign investors are free to employ foreigners in upper management and technical positions. The state is still responsible for disciplining workers and for regulating relations between foreign investors and their employees. Employee salaries will still be paid in national currency and foreign employees will continue to be able to repatriate their salaries in hard currencies. The new code, however, creates a potentially wide exception to the official labor regime by stating that a foreign investor may be authorized to utilize a different labor arrangement from that specified in the code.

Finally, Law XX generally maintains the existing tax structure for foreign investors. Foreign investors must pay taxes on net profits at 30% and payroll taxes at 25% to cover social security benefits. The tax rate on profits for investments that exploit renewable or non-renewable natural resources can be increased by the Cuban government up to 50%, depending on the natural resource being exploited.

The Ministry of Finance, in consultation with the MINVEC, can declare a foreign investment temporarily exempt from all or some of the applicable taxes. Likewise, although the tariff structure is not specified in the new law, special reductions in any applicable tariffs may be granted to certain foreign investors by Cuba's Customs Service. Thus, the tax regime for foreign investors under Law XX remains as vague and subject to the discretion of the Government as it was under Law 50.

3. Significant New Provisions in Law XX

Perhaps the most significant new provision in Law XX is an express guarantee against uncompensated expropriation of the property of foreign investors. The state also promises to reimburse the investor for the cost of any property involved in the venture which is subsequently subject to a successful claim to title by a third party. Compensation for expropriation is to be given in a convertible currency, although the amount and type of currency are left to be determined by a Cuban court, with the minimum value of the compensation to be set by an experienced "international organization" chosen by the foreign investor in conjunction with MINVEC.

Another important new provision allows investment by "enterprises with entirely foreign capital"—that is, investment without Cuban participation. The types of business organization allowed under the enterprise with entirely foreign capital provision are also new. Such enterprises can be established in two different ways: 1) by the foreign individual or entity registering in its own name with the Chamber of Commerce of Cuba; or 2) by setting up a wholly-owned Cuban subsidiary of a foreign entity.

Allowing foreign investors to operate as sole proprietorships or wholly-owned subsidiaries not only expands the types of business organizations available to foreign investors, but also moves Cuba's foreign investment legislation closer to internationally-recognized standards for foreign investment legislation. Experience in other countries shows that allowing 100% foreign ownership of enterprises is one of the elements of foreign investment legislation necessary to attract substantial amounts of foreign investment, particularly to countries with economies in transition. If enterprises wholly owned by foreign investors are allowed to acquire the assets of state-owned enterprises, this could signify the start of the process of privatization of state enterprises in Cuba.

The possibility that the Cuban government will allow the acquisition of state-owned assets by foreign investors raises issues regarding the status of title to properties expropriated after the 1959 Revolution. Cuban nationals and foreigners have outstanding claims on expropriated property totaling billions of dollars. The U.S. claims certified by the Foreign Claims Settlement Commission alone total $1.8 billion, before interest. The possibility that state-owned assets subject to expropriation claims could be acquired by foreign investors could complicate the resolution of the expropriation claims and delay the lifting of the U.S. trade embargo against Cuba, since the resolution of the property claims of U.S. nationals is one of the conditions necessary to lift the embargo.

Another provision enables foreign investors to acquire interests in real estate, but only in limited situations. Investments in real estate can only be made in structures intended as personal dwellings, vacation homes of non-resident foreign individuals, or residences of managers or corporate offices. It is unclear whether the acquisition of structures also includes the acquisition of the underlying land. More importantly, the term "acquisition" is not defined, and the terms and conditions under which real estate can be acquired are left to be set in the authorization issued to the foreign investor and are therefore subject to ad-hoc determination by the Cuban authorities.

Finally, the new Cuban foreign investment law establishes a system of "duty-free and industrial park zones," which apparently are some form of Export Processing Zones ("EPZs"). Special incentives may be granted to enterprises located in these zones. These incentives, again, are not defined in the law, but they are said to relate to "customs, exchange rates, taxes, labor, immigration, public order, investment and foreign trade." The types of activities which may be carried out in the duty-free zones include importation, exportation, storage, product modification, re-export and financial operations.

The duty-free zones probably will not attract large amounts of foreign investment. The worldwide record on the success of EPZs is mixed at best. In addition, the success of EPZs, particularly in the Caribbean, depends to a large extent on trade concessions from importing countries, which stimulate foreign investors to establish export manufacturing facilities ("maquiladoras") in the EPZs. A good example of this is the success of the Dominican Republic's EPZs in attracting apparel maquiladoras which take advantage of reduced quotas and import duties for their products under the US's Caribbean Basin Initiative ("CBI") program. Cuba presently is not eligible for CBI benefits, and it will continue to be ineligible as long as current U.S. policy remains in effect. In addition, even if Cuba were eligible for CBI benefits, the conclusion of NAFTA and the phasing out of the Multi-Fiber Agreement quotas under the Uruguay Round of the GATT have severely impaired the value of CBI benefits as investment incentives in beneficiary countries.

CURRENT CONSTRAINTS ON FOREIGN INVESTMENT IN CUBA

The present state of Cuba's foreign investment law is not unlike that of similar laws in Central and Eastern European countries, such as Hungary, the former Czechoslovakia, and Poland, prior to their transition to free-market economies. The constraints on foreign investment in Cuba today stem from both the internal controls that are still being imposed by the Cuban government, and by external factors that prevent the widespread entry of foreign investment. These constraints will be summarized next.

1. Constraints Placed on Foreign Investment by Cuba

Despite the post-1989 liberalization of Cuba's foreign investment law, there remain a number of specific restraints imposed by Cuba on foreign investment. These restrictions stem from the Cuban government's determination to maintain control over economic activity in the country. The following significant restrictions are still in effect:

- Foreign joint ventures still have to be individually authorized by the Cuban government, in a process that in the past has been protracted and has involved successive reviews by several agencies, ending up with Fidel Castro as the ultimate decision-maker in the approval of the venture. It does not appear that the new foreign investment law will do anything to alleviate this problem.

- Until recently, ventures were only permitted in selected areas of the economy; other areas, like the sugar industry, were considered off-limits. Investment in sugar is now starting, but is still limited to the pre-financing of sugar crops rather than the acquisition of productive assets. Even under the new law, investments in the sugar sector must be approved by Cuba's Council of Ministers.

- Since the objective of encouraging foreign investment is to secure foreign exchange via exports, investments directed at developing the internal Cuban market are generally not allowed.

- Foreign investors are still not permitted to acquire title to the properties in which they invest.

- A joint venture can still be terminated by the Cuban government essentially at will, with all property in Cuba involved in the venture remaining in the hands of the state.

- Contacts between the foreign investor and the internal economy of the country, and the population at large, are rather limited. As a general proposition, foreign venturers cannot hire labor directly, but must choose from a government-selected pool of candidates. The joint venturer must pay the Cuban agency that supplies the labor relatively high salaries in convertible currency, while the agency pays workers low salaries in pesos.

Although the new foreign investment law appears to provide an improved framework for foreign investment in the island today, it continues to suffer from such vagueness that the Cuban Government is free to exercise total control over the investment process and interfere with it arbitrarily by dictating the terms under which each investment is authorized. For those reasons, Cuba's transition to a free-market economy will require radical changes to the country's foreign investment regime.

2. External Constraints on Foreign Investment in Cuba

In addition to the internal constraints on foreign investment presented by Cuba's current regulatory environment, foreign investment is hampered by two main types of external constraints. First, Cuba is largely isolated from the international monetary and financial system because of its massive external debt burden, which denies it access to international credit. Second, Cuba is cut off from the U.S. market because the United States maintains a stringent trade embargo against Cuba and actively seeks to discourage trade and investment on the island by other nations. While a detailed discussion of these constraints is outside the scope of this paper, brief mention will be made of them to complete the picture of the foreign investment outlook in Cuba.

2a. Cuba's external debt

Cuba's external debt situation is bleak. Even before the collapse of the Soviet Union, Cuba owed about $7 billion (not counting accrued interest) to international private and public lenders in the West, and had defaulted on its loan obligations. As a result, Cuba is not eligible for credit from Paris Club members or private lenders. Also, Cuba owes Russia, as successor to the Soviet Union, about $30 billion in loans that it has never repaid.

Cuba is also not a member of the IMF and does not receive export credits from foreign governments except for Spain and France, which are actively encouraging their nationals to do business in Cuba. The country's inability to secure credit from the world's financial institutions restricts its ability to finance projects and limits both the number of investors and the types of investment projects that can be undertaken.

2b. The U.S. Trade embargo

The U.S. trade embargo is also a factor that greatly restricts foreign investment in Cuba. The embargo prohibits U.S. individuals and companies, and their foreign subsidiaries, from doing business in Cuba. Moreover, the U.S. pursues a policy of actively seeking to discourage third country entrepreneurs from investing in Cuba.

One of the arguments used by the U.S., sometimes effectively, to discourage third country investors from going into Cuba is that many of the joint ventures solicited by Cuba involve properties that were confiscated from U.S. citizens. The U.S. warns that investment in such properties could lead to litigation against the investors now or in the event of a change of government in Cuba. Also, it is sometimes said that those investing in Cuba might be subject to adverse action by a successor government coming to power on the island.

There is proposed legislation currently pending before the U.S. Congress (the LIBERTAD Act) that would greatly increase the potential for litigation in the U.S. against third country investors in Cuba, and would subject such investors to sanctions in the areas of immigration, trade, and financing. This legislation, if enacted, could further cloud the picture for third party nationals contemplating investing in Cuba.

OBJECTIVES OF A FOREIGN INVESTMENT CODE FOR A COUNTRY IN TRANSITION

1. Introduction

Foreign investment legislation can seek two goals which are largely contradictory: on the one hand, enabling and fostering the entry of foreign investment; on the other, regulating and controlling such investment to minimize its adverse impacts on the host country. Which of these two goals is pursued at a given time depends on the philosophy of the government then in power, as well as on prevailing political and economic conditions.

Until the last decade, a "provider mentality" pervaded most developing countries. This mentality was based on the belief that having an ample stock of natural resources was what made a country rich and its products competitive. This mentality caused many countries to effectively close their doors to perceived exploiters—investors from industrialized countries and multi-national corporations. Thus, countries enacted laws that emphasized the regulatory and exclusionary aspects of foreign investment legislation and thereby tended to discourage, rather than stimulate investment.

Other countries, particularly those in the Pacific rim, started some time ago to shrug off the provider mentality and open their markets to foreign investment. The results have been dramatic. Countries like Malaysia have become active and successful participants in the global marketplace. Their experiences are living proof of the wisdom of opening the door wide to foreign investment. Likewise, the successful experience of Central and Eastern European countries underscores the critical role foreign investment legislation of the "enabling" type plays in the rebuilding of the economies of countries in transition.

2. Fundamental pillars of foreign investment legislation

The main objective of an "enabling" type of foreign investment code is to create a legal and regulatory regime attractive to foreign investors. In order to achieve this goal, the foreign investment framework needs to meet at least three criteria: 1) it must provide for non-discriminatory or "national" treatment of foreign investors; 2) it must grant adequate protection to the foreign investors' property, and 3) it must establish streamlined foreign investment regulations and procedures. These criteria provide the fundamental pillars of successful foreign investment legislation.

a. Non-Discriminatory or "National" Treatment of Foreign Investors

"National treatment" is a crucial element of a hospitable foreign investment regime. National treatment means that foreign investors should not be put at a competitive disadvantage versus domestic investors regarding access to permits or authorizations necessary to conduct operations in the host country. At the same time, the laws should not give foreign investors a competitive advantage over national investors, absent compelling circumstances. In other words, the laws should apply fairly and equally to all investors.

b. Protection of Foreign Investors' Property

Adequate protection of the investors' property is also a fundamental pillar of a favorable foreign investment climate. Such protection has several elements. The most obvious and important one is a guarantee against the uncompensated taking of the investors' property by the state.

Another type of protection that must be given to foreign investors is the avoidance of excessive taxation and other forms of regulation that diminish the value of the investment. Foreign investors should also be free from discriminatory treatment, and should receive the same protection of their persons and property (including intellectual property rights) as that accorded to nationals.

3. Streamlined Foreign Investment Regulations and Procedures

The third fundamental pillar of a favorable foreign investment regime is a regulatory process free from bureaucratic impediments to investment. The concept of "one-stop shopping" has been postulated as the ideal method for streamlining foreign investment regulations. Under this concept, there is a central office where foreign investors can register and satisfy all other requirements to set up their enterprises. The obvious benefits of such a central office are time and transaction costs savings for foreign investors. Other advantages of the central office concept are the reduction of administrative costs, the elimination of duplicative government structures, and the minimization of conflicting requirements and interpretations of existing laws. An indirect, but perhaps important advantage of the establishment of a central agency to deal with foreign investors is that it gives the investors a single contact with whom to deal to obtain advice and resolve problems as they arise.

SPECIFIC OBJECTIVES OF FOREIGN INVESTMENT LAWS IN COUNTRIES IN TRANSITION

1. Introduction

In addition to the "fundamental pillars" on which successful foreign investment regimes rest, conditions in countries making a transition from socialism to a free-market society warrant that additional objectives be fostered by the foreign investment codes and related legislation. Following is a discussion of four such additional objectives. The continued relevance of these specific objectives depends, of course, on the conditions that exist in a country as the transition unfolds.

2. Promotion of Rapid Investment in the Country's Infrastructure

After years of communist rule, important elements of the infrastructure of countries in transition are likely to be in a state of disrepair. In Cuba, early foreign investment will be required to rebuild, enhance and modernize critical areas of the infrastructure, such as energy production, telecommunications, and transportation. These sectors of the economy are not only crucial to the welfare of the population, but their upgrading is required to attract foreign investment. Given the importance of rapidly modernizing Cuba's infrastructure, foreign investment legislation should not unduly burden investments in this area but, to the contrary, encourage the participation of foreign investors in these "strategic" sectors.

3. Promoting the Transfer of Modern Technology

Recent experience in Central and Eastern European countries in transition suggests that foreign investment has, at least in the short run, helped reduce the gap between the state of technological development in those countries and conditions in the rest of the industrialized world. Foreign investors have consistently installed the latest (or near-latest) technologies in their facilities in Eastern and Central Europe. Foreign investment legislation, therefore, should foster investments that will introduce state-of-the-art technologies during the transition period, and should provide adequate protection of the foreign investors' technology to encourage its importation into the country. Such protection should be afforded by the foreign investment code and other laws, particularly the intellectual property laws.

4. Fostering Employment-Creating Enterprises

An important objective of foreign investment legislation of countries in transition is to encourage the creation of new sources of employment for the population during the transition to a market economy. There are two reasons for this importance.

First, one of the effects of the transition process is a rise in unemployment as inefficient state enterprises shut down and the government bureaucracy is culled. The experience in many Central and Eastern European countries (and some Latin American countries implementing radical economic reform packages) is that the rise in unemployment leads to social instability and popular backlash against the economic reform process. To minimize these phenomena, foreign investment in employment-creating enterprises should be encouraged as a way to promote social stability and ensure the orderly implementation of economic reforms.

Second, employment in foreign-owned enterprises exposes the domestic labor force to modern work practices that improve productivity. Typically, much of the work force in countries in transition lacks the skills and discipline necessary to improve productivity and compete in the global marketplace. In addition, those countries suffer from an acute shortage of qualified management personnel during the transition to a market economy. Foreign investors in Central and Eastern Europe have introduced market-tested management skills that have trickled down to indigenous enterprises.

5. Improving the Balance of Payments

Countries in transition in Central and Eastern Europe have relied on foreign investment to increase exports and thus improve their balance of payments. Indeed, an important objective of the foreign investment regime of a country in transition should be to encourage investment in export-oriented enterprises.

As further discussed below, both the general and specific objectives of a foreign investment code described above are applicable to Cuba and should be included among the goals of that country's foreign investment legislation during its transition.

RECOMMENDED ELEMENTS OF A CUBAN FOREIGN INVESTMENT CODE

1. Introduction

The concepts discussed in previous sections can be applied to determine the type of foreign investment code that would be most beneficial to Cuba during its free-market transition. Two important observations need to be made at the outset. First, as the experience in Eastern European countries shows, it is very difficult if not impossible to develop a suitable foreign investment code in a single try. Several attempts are often necessary, either because the starting point of the effort is an inadequate code which must be molded in incremental steps into a workable piece of legislation, or because the contents of the legislation are driven by political and economic conditions that are in a state of flux.

Second, if a choice is to be made between speed and perfection, speed should prevail. There will be a great need in Cuba for foreign investment legislation that meets the country's, as well as the investors' requirements. Under those circumstances, it will be preferable to have adequate but perhaps less than perfect legislation enacted early than to hold up passage while seeking to refine the formulation.

A third observation follows from these two. The first foreign investment code that is enacted during Cuba's transition should be kept as simple as possible in an effort to shorten the drafting period, minimize debates among the decision-makers, and avoid causing strain in the transition period government structures, which may not be capable of administering overly complex statutes.

For these reasons, the substantive provisions discussed below may not all be capable of early implementation. The highest priority provisions, and consequently those that must be included from the start in the Cuban foreign investment code are those provisions granting "national" treatment to foreign investors and allowing 100% foreign ownership of Cuban enterprises; those guaranteeing full compensation in the event of expropriation; those removing restrictions on profit repatriation; and those streamlining the regulation of foreign-owned enterprises. We discuss these most urgent items first, and then turn to less pressing provisions that should eventually be included to give effect to Cuba's foreign investment objectives.

2. Provisions to implement the fundamental pillars of foreign investment legislation

a. Introduction

Foreign investors considering going into Cuba during its transition must be reassured that no burdensome limitations, conditions, or impediments will be placed on their ability to operate in the country; that their investment will be protected against adverse actions by the state; and that they will be able to repatriate profits and move capital in and out of the country without restrictions. In short, the investment climate must be fair and favorable to the investor. This section discusses the main foreign investment code provisions that will create such a favorable investment climate in Cuba.

b. Guaranteeing National Treatment

Equal treatment of foreign investors in Cuba could be guaranteed through express declarations in the Foreign Investment Code (and perhaps the Constitution) that foreign investors enjoy the equal protection of Cuba's laws and are subject to the same treatment afforded domestic individuals and enterprises. To the extent that any distinctions need to be made between foreign and domestic business entities, such distinctions should be clearly defined and should be identified in the Foreign Investment Code, or cross-referenced there to other applicable legislation.

For domestic political reasons, it is also important to avoid creating the impression that foreign investors are being given advantages over the country's nationals. This is crucial in Cuba, where growing resentment exists over special treatment accorded to foreigners by the current Cuban Government. Continued special treatment for foreign investors may be poorly received by the Cuban people, and may serve as political ammunition for those opposed to economic reform.

c. Eliminating Restrictions on Property Ownership by Foreign Investors

Restrictions on foreign equity participation in domestic enterprises are designed to ensure direct or indirect state control over the enterprises, reduce the profits repatriated abroad, and force the transfer of business know-how and technology to the local participants in the venture. These restrictions (typically in the form of mandatory percentages of local equity participation in foreign-owned enterprises) are most often imposed in "strategic" national industries such as utilities or telecommunications companies.

These types of restrictions have been prevalent in Cuba. As noted earlier, under Law 50 majority participation by local enterprises was a requirement, or at least a practice followed in most instances. Under Law XX, it would be possible for a foreign investor to be sole owner of its enterprise. However, if the law is enacted in its current form it will be interesting to see whether such investments will actually be permitted, particularly in sensitive areas of the economy.

All equity participation restrictions should be abolished in Cuba's foreign investment legislation. Restrictions on equity participation in domestic enterprises generally deter foreign investment. Under the principle of "national treatment," foreign investors should be able to use the same forms of business organization available to nationals, without additional equity participation restrictions.

The experience of countries in transition in Eastern and central Europe, which now allow 100% foreign ownership of domestic enterprises, supports the wisdom of removing restrictions on equity participation. Several countries in Latin America, including Mexico and Venezuela, have also eliminated or relaxed restrictions on foreign equity participation, although significant restrictions remain in place in some countries.

3. Protection Against Uncompensated Expropriation of Property

a. Domestic Law Protections

Considering Cuba's history of private property takings, providing strong guarantees against uncompensated expropriation must be an essential element of its foreign investment legislation. Guarantees against uncompensated expropriation should be incorporated into the country's Constitution and restated in the Foreign Investment Code.

As important perhaps as giving express guarantees against uncompensated expropriation is setting forth a proper standard for compensation in the event of expropriation. The internationally-recognized standard is the formulation coined in 1938 by U.S. Secretary of State Cordel Hull: "prompt, adequate and effective compensation." The World Bank Guidelines incorporate this standard. Under current practice, the "prompt" element of the Hull formula means payment without delay.

The "adequate" element means that the payment should reflect the "fair market value" or "value as a going concern" of the expropriated property. The "effective" element is satisfied when the payment is made in the currency brought in by the investor, in a convertible currency (as designated by the International Monetary Fund), or in any other currency acceptable to the investor.

b. Use of Bilateral Investment Treaties

Bilateral investment treaties ("BITs") protect investors from a signatory country providing a framework in the host country for national treatment of such investors and setting up dispute settlement procedures, methods for compensation for expropriation, and guarantees of the convertibility and repatriation of profits. Given the increasing use of BITs, particularly by the United States, Cuban foreign investment legislation should authorize and call for the conclusion of such agreements.

c. Multilateral Dispute Resolution Agreements

The International Convention on the Settlement of Investment Disputes Between States and Nationals of Other States ("ICSID Convention") is a multilateral agreement intended to reduce foreign investor concerns by helping resolve investment disputes, including those relating to expropriations. Accession to the ICSID Convention allows a signatory state and a national of another signatory state to submit their investment disputes to arbitration by the International Centre for the Settlement of Investment Disputes ("ICSID"). The Convention also establishes an Additional Facility for the Administration of Conciliation, Arbitration and Fact-Finding Proceedings, which is a mechanism for settling certain disputes outside ICSID's jurisdiction under the ICSID Convention.

Cuba should become a party to the ICSID Convention so that, if Cuban government agencies or instrumentalities continue to enter into joint ventures with foreign investors, the joint venture agreements can refer contractual disputes to ICSID arbitration. Cuba's participation in the ICSID would provide further assurance to foreign investors that the country is prepared to honor its commitments to them and treat them fairly.

d. Investment Insurance: OPIC, MIGA, and Private Insurers

As an additional incentive for foreign investment, the Cuban government should assist foreign investors to obtain Overseas Private Insurance Investment Corporation ("OPIC") or Multilateral Investment Guarantee Agency ("MIGA") coverage. OPIC is a corporation owned by the United States government which offers political risk insurance, loan guarantees, and direct loans to U.S. businesses which invest in foreign countries. OPIC also offers insurance against inconvertibility, that is, "the inability of an investor to convert into dollars the local currency received as profits, earnings or return of an original investment." In order for U.S. investors to, become eligible for OPIC coverage, the host country (Cuba, in this case) needs to enter into an agreement with the United States which enables the U.S. government to authorize OPIC coverage for qualifying investments in Cuba.

MIGA is an investment guarantee agency operated under the auspices of the World Bank. MIGA offers guarantees and reinsurance to eligible investments against losses resulting from four categories of non-commercial risks: 1) the transfer risk resulting from host government restrictions on currency conversion and transfers; 2) the risk of loss resulting from legislative or administrative actions or omissions of the host government which deprive the foreign investor of ownership or control of or substantial elements of his investment; 3) the repudiation or breach of government contracts in cases where the investor has no access to a competent judicial or arbitral forum, or faces unreasonable delays in such a forum, or is unable to enforce a judicial or arbitral decision issued in his favor; and 4) the risk of armed conflict and civil disturbance. MIGA will not issue a guarantee to an eligible investor without the host government's approval of the guarantee. Cuban foreign investment legislation, therefore, should include specific provisions for the expedited approval of MIGA guarantees.

Apart from any Cuban government undertakings to assist foreign investors to secure investment guarantees, the investors may also take steps to purchase private investment insurance. Insurance from private companies, such as Lloyd's of London, offers several advantages over OPIC or MIGA investment insurance. Private insurers frequently cover existing projects, while OPIC only covers "new" projects. Private insurers may also cover a wider range of contingencies, resolve claims more quickly, and indemnify a greater amount of loss than OPIC or MIGA.

While obtaining private insurance is the responsibility of the foreign investor, Cuba should avoid adopting laws or regulations that impair the activities of investment insurers. The Cuban government should also cooperate with insurers seeking to settle claims filed by investors under their policies.

e. Guarantees Of Currency Convertibility And Profit Repatriation Rights

Free convertibility of currency and unrestricted ability to repatriate profits are aspects of a foreign investment regime that are particularly important to investors. Most Central and Eastern European countries have removed restrictions on profit repatriation from their foreign investment regimes. The World Bank Guidelines also emphasize the importance of unrestricted repatriation of profits to foreign investors. Cuba provides such rights to investors under the existing and proposed foreign investment laws. These benefits should be retained in the transition period legislation.

The scope of any future controls that might be imposed on the convertibility of currency held by foreign investors would depend on the Cuban government's macro-economic policies during the transition to a free-market economy. In the interest of fostering foreign investment, however, Cuba should refrain from imposing restrictions on the repatriation of after-tax profits by foreign investors.

f. Reduction in Pre-Approval Requirements

Government pre-approval requirements often pose a significant hurdle to foreign investment. Most Central and Eastern European countries have abolished pre-approval requirements, and have simplified the procedures necessary to set up an enterprise. Many Latin American countries have also streamlined pre-approval procedures in an effort to facilitate foreign investment. The Cuban government should follow these examples and abolish or minimize pre-approval requirements for foreign investors.

Special attention should be paid to the manner in which any pre-approvals are processed. Cuba's foreign investment legislation should establish a single government agency or institution with pre-approval authority over all foreign investment. Worldwide experience suggests, however, that concentrating pre-approval authority in one government institution leads to problems in the issuance of post-approval licenses and permits to the foreign investor by other government agencies, which often seek to reassert their authority after the pre-approval process. Future Cuban foreign investment legislation, therefore, should include provisions for the automatic issuance of certain authorizations or permits upon approval of the investor, and prohibitions against lengthy evaluations of projects by institutions that control licenses and permits.

As important as the institutional aspects of investor approvals are the procedures used in the approval process. Project-by-project screening is probably the most cumbersome form of evaluation and the one most likely to hinder foreign investment. Given the importance of stimulating the rapid entry of foreign capital into Cuba, project-by-project evaluations should be abandoned. Instead, a well-defined list of requirements for investment should be set, and if sectors of the economy are to be declared off-limits to foreign investors, those should be clearly identified in the legislation so that the identification may serve as a sufficient screen. From the standpoint of a potential investor, a "negative list" describing restricted sectors would be preferable to a "positive list" of sectors open to foreign investment.

g. One-Stop Shopping

Cuba's Foreign Investment Code should establish a central office before which foreign investors can satisfy all requirements for setting up their enterprises. As noted above, the benefits of a centralized approval system include savings in time and transaction costs for foreign investors and the elimination of investment disincentives, such as duplicative regulations and multiple regulatory entities.

The one stop-shopping concept should also be applied to unifying the foreign investment regulations. Placing all the regulations affecting foreign investment in a single code (or cross-referencing all the regulations affecting foreign investment) would eliminate duplicative or inconsistent regulatory actions. The Foreign Investment Code should also include a "residual clause" stating that, to the extent not covered by its specific provisions, a foreign investor has the same rights, and is subject to the same rules and regulations, as a domestic person or entity.

A useful tool to foreign investors would be a regularly-updated handbook published by the Cuban government which contains information about legislation, regulations and procedures relevant to foreign investment. The central office handling foreign investor applications and inquiries should be charged with the task of publishing the handbook and distributing it to prospective investors.

4. Foreign investment code provisions to meet specific economic or political objectives

a. Introduction

The provisions discussed in this subsection favor foreign investment in particular sectors of the economy by giving investors in those sectors monetary advantages in the form of reduced taxes or tariffs. These types of provisions, however, have supporters and detractors, as their success in stimulating foreign investment is far from proven. They merit examination, nonetheless, because they are tools available to the lawmakers to channel foreign investment into areas where it is most urgently needed.

b. Special Tax Preferences

Special tax preferences, which are a form of subsidy, remain the most common incentive offered to foreign investors. Tax incentives are often used as a form of "signaling," to denote a country's desire to attract foreign investment in a given sector or across the board.

Many commentators have noted that special tax incentives, standing alone, do not appear to attract foreign investment. The World Bank Guidelines recommend against special tax incentives for foreign investors. Most of the countries of Central and Eastern Europe have rescinded their special tax incentives for foreign investors after having them in place for a few years, and now treat foreign and domestic investors on equal terms. Indonesia also abolished its special tax incentives in 1985, and the subsequent large inflows of foreign capital into that country suggest that the special tax incentives were not essential to attract foreign investment.

The experiences of countries which have abolished special tax incentives suggest that such incentives should not be included in Cuba's foreign investment legislation, except possibly for investment in infrastructure, high technology, and other areas deemed crucial to the economy in the early stages of the transition. Any tax incentives given should be of only limited (three to five years) duration.

c. Tariff Reductions

In general, the use of tariffs in Cuba will probably be governed by the rules of the World Trade Organization's General Agreement on Tariffs and Trade ("GATT"), and those of regional trade agreements that Cuba may join. Beyond those, Cuba's use of tariff reductions to foster foreign investment also hinges on the transition government's broad economic and development policies.

Cuba could, for example, decide to eliminate tariffs altogether, in line with certain economic arguments sometimes made against the use of tariffs in developing countries. The elimination of tariffs may attract foreign investment, particularly in the manufacturing sector, since the entire country would, in essence, become an export-processing zone. The loss of tax revenue from the elimination of tariffs could be offset by additional foreign investment and the consequent expansion of the tax base. Repealing tariffs would also eliminate the often time-consuming collection procedures, and allow disbanding the entities charged with tariff collection.

d. Export-Processing Zones

If Cuba eliminates import and export tariffs and makes very limited use of special tax incentives to foreign investment, the establishment of export-processing zones will not provide a significant further boost to foreign investment. If tariffs are retained, on the other hand, EPZs may provide some investment incentives, and may be used to encourage investment in rural areas which would otherwise see little investment in areas such as manufacturing.

The success of EPZs in Cuba may depend to a great extent on the macro-economic policies adopted by the Cuban government. If the Cuban government imposes controls on the convertibility of foreign exchange, the establishment of EPZs offering unrestricted convertibility of foreign exchange and repatriation of profits may attract foreign investment to the EPZs in the manufacturing of products for export. Special tax incentives may also attract foreign investors to EPZs, although some data suggest otherwise.

e. Trade-Related Investment Performance Requirements

Trade-Related Investment Performance Requirements ("TRIPs") are, in essence, host government policies which guide foreign-owned firms into engaging in a particular type of activity. The two most common forms of TRIPs are export quotas and local content requirements.

Export quotas and local content requirements do not appear to discourage foreign investment in many cases when other factors, such as attractive locations, protected markets, or other incentives offset the costs of the requirements. On the other hand, the World Bank Guidelines suggest that the imposition of TRIPs deters foreign investment, and that they are becoming rare. Since Cuba probably will not have the resources to adequately implement and monitor a TRIPs program, TRIPs should not be included in Cuba's foreign investment legislation.

In addition, the United States views export controls as violating standards of free-trade and creating trade distortions. The United States also contends that export controls violate the GATT, although a GATT panel upheld the validity of specific export targets in the Canadian Foreign Investment Review Act of 1982. Given that the United States will most likely become Cuba's most important source of foreign investment during the market transition, it is critical that Cuban decision-makers not impose requirements in this area that run counter to the U.S. positions.

RELATIONSHIP BETWEEN FOREIGN INVESTMENT LEGISLATION AND OTHER TRANSITION LAWS

1. Introduction

Foreign investment in a country in transition does not occur in a vacuum but, rather, operates within a legal framework that reflects the country's stage of development and the political and economic circumstances of the transition. This section explores briefly several areas of the law that are not specifically related to foreign investment but which may impact on a foreign investor's ability to operate in the country or otherwise affect his decision whether to invest.

The discussion that follows must by necessity be summary and is not intended to examine all the issues that are raised in each area of the law that is examined.

2. Laws that may encourage foreign investment

a. Business Organization Laws

Applying the principle of national treatment discussed earlier, foreign investors should be able to conduct operations in Cuba using the same types of business organization available to Cuban nationals. This principle has been taken to heart in Central and Eastern European countries, which allow foreign investors to use all form of business organization recognized by local law (e.g., corporations, limited liability companies, partnerships, etc.). The types of business organization available to foreign investors in Cuba should be those recognized by the new Companies Law that Cuba needs to enact early during its transition to a market economy. Corporate laws should authorize at a minimum those forms of business organization with which foreign investors are most familiar. Cuba could adopt as a model, for example, the business organizations forms accepted by most Latin American countries, and in doing so it would reduce transaction costs for investors interested in doing business in the island.

b. Privatization Laws

Foreign investors going into Cuba will in many cases want to participate in the privatization of state-owned enterprises. Privatization is an extremely complex process, which, in the case of Cuba, will be closely tied to the program Cuba develops for resolving the outstanding property expropriations claims.

There are advantages to conveying state-owned enterprises to foreign investors as part of the privatization process. Foreign investors bring with them capital resources, management skills, business know-how, and improved technology, plus the ability to incorporate local enterprises into the global networks of production and commerce. Allowing foreign investors to participate in the privatization of state-owned enterprises also enables the country to earn much needed foreign exchange, an important consideration for what will certainly be a cash-strapped Cuba. Encouraging the participation by foreign investors, therefore, should be an important goal of the Cuban privatization program.

Foreign investors are mostly interested in acquiring medium and large enterprises being privatized. The opportunities for investment in such enterprises, however, may be limited by the potential restitution of some properties to their former owners which might reduce the number of enterprises eligible for privatization.

The Cuban government could also elect to limit foreign investor participation in the privatization of certain state-owned assets, particularly those in "strategic" sectors of the economy. The original Polish privatization statute, for example, limited the extent of foreign owned stock in privatized companies to 10%. However, since revamping the country's infrastructure is an urgent goal during the transition period, Cuba should not restrict foreign participation in privatized enterprises, particularly those in strategic sectors.

The opportunities for foreign participation in the privatization of state-owned enterprises may be limited as a practical matter by the deterioration or obsolescence of the assets of those enterprises. Foreign investors may prefer to invest in new ventures rather than in dilapidated state-owned enterprises.

Whatever the extent of foreign investor involvement in the privatization of state-owned assets, the Cuban government should ensure that investors face as little uncertainty as possible if they choose to become involved in the privatization process. This means that programmatic issues concerning the title to state-owned assets should be settled very early in the privatization process. In addition, the approval process for the sale of state-owned assets to foreign investors should be made as simple as possible. (In the early days of privatization in Poland, for example, the sale of a state-owned enterprise often required approval by the Workers' Council after consent by a general assembly of workers, and also by the Ministry of Ownership Transformation; not surprisingly, these cumbersome approval requirements discouraged foreign investors.) Cuba should set up a privatization agency that provides a "one-stop shopping" for privatizations. The existence of such an agency would facilitate foreign participation in the privatization process.

c. Intellectual Property Rights Protection

Cuba's ability to provide effective protection to foreign investors' intellectual property rights will be a crucial factor in the country's ability to attract many types of foreign investment to the island. In addition, Cuba may will need effective laws to protect the rights to its own technological achievements, particularly in biotechnology and related fields.

The Cuban government should therefore strive to provide legal protections for intellectual property rights which meet the prevailing standards in other countries. The United States, in particular, is aggressive in demanding the protection of intellectual property rights owned by its enterprises and individuals, and often takes action against foreign governments seen as tolerating the infringement of U.S.-owned intellectual property rights.

There is no comprehensive, internationally-recognized set of standards for the protection of intellectual property rights which could serve as a model for Cuba. However, the Uruguay Round of the GATT contains an Agreement on Trade-Related Aspects of Intellectual Property Rights (hereinafter "TRAIPs Agreement," not to be confused with Trade Related Investment Performance Requirements discussed earlier), which contains provisions "for the establishment of standards to protect a full range of intellectual property rights, and for the enforcement of those standards both internally and at the border." The TRAIPs Agreement establishes minimum standards for the protection of intellectual property for patents, trademarks, and copyrights, although several important aspects of intellectual property are not addressed. Cuban intellectual property law should at a minimum seek to meet the standards of the TRAIPs Agreement.

The protection of confidential information, trade secrets, and know-how against disclosure or misuse by employees is another important aspect of intellectual property rights protection which is usually addressed by employment contracts and domestic tort laws. Cuba's tort laws should include provisions allowing employers—including foreign investors—to terminate current employees and sue former ones who divulge confidential information, trade secrets, or know-how to competitors, irrespective of whether such rights are included in the employment agreement. In addition, government sanctions should be established against employees who wrongfully divulge confidential information, trade secrets, or know-how. The sanctions could include, for example, withholding unemployment compensation and other benefits.

d. Tax Laws

A country's attractiveness to foreign investors depends in large part on its system of taxation. During its market transition, Cuba may opt to pursue tax reforms that specifically benefit foreign investors. See Section IV.C.2 above. In any case, Cuba should implement changes to its tax laws that benefit foreign investors indirectly by establishing an equitable and predictable system for all taxpayers. Indeed, experience with tax reform in developing countries shows that a healthy tax system is a pre-requisite to foreign investment, irrespective of whether preferential tax treatment is accorded to foreign investors.

A comparison between the experience of Bolivia in the 80s with that of present- day Russia is instructive in this regard. Tax reform in Bolivia in 1986 succeeded in bringing inflation down from an annual rate of 12,000 percent to 14 percent in the space of two years. The reform also sufficiently stabilized the tax environment to reverse the effects of a fiscal crisis occasioned by a world recession in the early 1980s that had all but cut off the flow of foreign investment. In contrast, Russia has created a patchwork quilt of tax laws and has implement piece-meal tax reforms, leading to an overall climate of regulatory uncertainty that deters foreign direct investment.

To be supportive of foreign investment, Cuba's tax system should be simple, uniform, centralized, and well-administered. Good administration is key: in the early stages of its transition to a free-market economy Cuba, like many developing countries, will likely face the problem of poor tax administration, which may effectively negate the benefits of even the most enlightened tax code. Likely lapses in administration should be compensated by devising a tax system that features a simple rate structure and few, broad categories of taxes that apply equally to foreign and domestic businesses. Cuban tax legislators would be well advised to use tax exemptions and targeted tax incentives gingerly, and to resist populist pressures to implement redistributive measures such as steeply progressive rates. Close attention should be paid to improving collection techniques and properly screening personnel in order to minimize the possibility of corruption by tax collectors and other officials.

It is equally important that the tax system be centralized. During their market transitions some countries, notably Russia and China, devolved taxing power from the central authority to the local governments. Though perhaps ultimately desirable, early tax decentralization has led in those countries to competing tax initiatives by central and local governments, resulting in an increased overall burden on the taxpayer.

In addressing the specific tax concerns of foreign investors, elimination of double taxation should be a top priority. Most countries follow the "territorial method" of taxation and levy taxes on all income earned in the country, whether by a citizen or a foreigner. Some countries, however, tax their residents on their world-wide income (using a "residence-based method"), and several countries combine the two methods. Double taxation results when an investor's home country and the host country follow different methods, so that the profits generated by the investment are taxed by the host country under the territorial method, and by the home country under the residence-based method.

The two devices most commonly used to alleviate the double-taxation problem faced by foreign investors are double-taxation treaties and foreign tax credits. Treaties for the avoidance of double taxation (i.e., bilateral agreements setting the order of taxation) are favored by those countries that follow the territorial principle (e.g., most countries in Western Europe), while foreign tax credits are used by those countries that tax their residents on their world-wide income (e.g., United States, China and Russia) as a way to offset the amount of foreign tax already paid. Cuba should use both treaties and foreign tax credit statutes to assist investors from countries using both systems.

Finally, Cuba should pursue a tax reform program that emphasizes consistency and advance planning. No changes should be introduced without affording those affected advance notice and opportunity for comment, and grandfathering provisions should be used where appropriate. There should also be no sudden reversals of those reforms already in place - a practice aptly termed "deform" in which, for example, present-day Russia and Colombia in the 1970s have engaged. Together with sensitivity to the tax pressures faced by foreign investors at home, consistency and ample advance notice would create a predictable tax environment that will encourage foreign investment in Cuba.

OTHER LAWS HAVING POTENTIAL EFFECTS ON FOREIGN INVESTMENT

1. Introduction

In addition to those laws that should be expected to have a positive effect on foreign investment, there are other laws that are not directly related to foreign investment, but which may indirectly affect foreign investment by improving the economic climate or, alternatively, by imposing requirements that raise costs or make the investment process more difficult. This section surveys five such types of laws.

2. Economic Restructuring Laws

Economic restructuring legislation will need to be enacted early in Cuba's transition to carry out the transformation from a centrally-planned economy to a free-market one. Some of that legislation may serve to unleash market forces and thereby foster foreign investment.

An example of economic restructuring legislation that would have beneficial impact on foreign investment would be price de-control measures. Elimination of government controls on prices is one of the basic requirements for the establishment of a free-market economy, and one that has been accomplished in most countries making the transition from socialism in Central and Eastern Europe.

A detailed discussion of economic restructuring laws is outside the scope of this paper, however, such laws provide an essential backdrop to any efforts to foster foreign investment in Cuba during its free-market transition.

3. Worker Benefits and Foreign Labor Restrictions

Labor laws and regulations, and the costs they impose on employers, are an important factor of the investment climate. In enacting new labor laws and regulations, the Cuban Government must make a trade-off between providing worker benefits and social safety nets to promote social stability, and cutting operational costs to employers so as to promote foreign investment. It seems likely that the extensive social safety net now in place in Cuba will be preserved to some extent during the country's transition to a market economy. This prospect is reinforced by the experience of most Central and Eastern European countries, which have chosen, or been forced, to preserve their well-developed social safety nets.

If Cuba retains a significant social safety net it should takes steps to clearly define foreign employers' liabilities and responsibilities towards the labor force. These steps should include provisions requiring communicating to foreign investors all social safety net laws to which they may be subject.

The Cuban government may also come under pressure to impose restrictions on the private enterprises' ability to hire foreign employees. Such restrictions could include the need to obtain work permits and the placement of limits on the number of foreign employees allowed at an enterprise. Restrictions on foreign employees, such as work permits, are in use in many countries.

In developing the transition period labor laws, provisions which require local labor participation (i.e. mandating the hiring of local management personnel) should give way to allowing investors freedom in their employment decisions, because provisions regulating foreign investors' hiring practices will probably deter some types of investment, particularly those calling for workers with skills in short supply in the country.

4. Immigration Laws and Restrictions

As Cuba's transition progresses and the country's political and economic situation settles, foreign investors will probably seek to visit the island in increasing numbers. The Cuban government should take steps to facilitate temporary visits and the long-term or permanent migration of foreign investors.

One important issue which needs to be resolved in developing an immigration regime for foreign investors is the immigration treatment of Cuban expatriates who wish to invest in Cuba. Should they be considered "foreign" investors and be eligible for any special benefits given to such investors? On the one hand, the definition of who is a foreign citizen should be as broad and inclusive as possible to maximize the inflow of foreign-based capital. On the other hand, granting Cuban expatriates privileges unavailable to resident nationals could lead to resentment from people on the island. This is an extremely sensitive political issue that is part of the broader question of the citizenship status and rights of those Cuban nationals who have moved abroad and acquired foreign citizenship.

One component of the immigration treatment of foreign investors is the visa structure for business travelers. A business visa structure during Cuba's market transition will probably follow one of four typical patterns:

- No visa requirement for short-term business trips. A visa would be required only if the trip was to extend beyond the designated period. Several countries, such as Chile and Czechoslovakia, have implemented this type of visa structure.

- No visa requirements for business travel, unless the foreign national will be employed during the trip. Several Western European countries have a visa structure along these lines.

- A visa structure similar to that of the United States, under which there would be several categories of business visas corresponding to the nature of employment performed in the host country and the duration of the stay.
- A requirement that all business visitors obtain a visa, with different eligibility criteria depending on the purposes and intended length of stay.

In developing its business visa structure, the Cuban government should keep in mind several important considerations regarding foreign investors:

- First, and probably most importantly, foreign investors should have the ability to employ foreign personnel, particularly for key positions. The Cuban government should therefore refrain from unduly limiting the number of foreign personnel a company can bring into the country, or imposing unreasonable time limits on their visas. As noted earlier, there will be an acute shortage of skilled management personnel in Cuba during the transition to a market economy, so a large number of foreign managers will be necessary to operate foreign investors' enterprises until the local population acquires the requisite management and other business skills.
- Second, the Cuban business visitor visa structure should not establish special visa categories for particular classes of foreign investors. An example of this type of visa is the "alien entrepreneur" visa program in the United States, which reserves a certain number of immigrant visas for investors "who establish new commercial enterprises in the United States, invest at least $1,000,000 . . . and employ at least ten Americans." This type of special incentive is warranted only if a restrictive business visa structure is in place, which should not be the case in Cuba during the transition to a market economy; both large and small investors should be allowed free and easy access to the island.

Finally, the business visa structure during the transition period should be kept simple. Keeping the business visa structure simple would reduce time and transaction costs for foreign investors, and thus encourage foreign investment. In addition, a simple business visa structure would reduce the cost and complexity of administering the program, another important consideration given Cuba's lack of resources.

5. Environmental Laws

During the early phase of its transition to a market economy, Cuba may refrain from imposing major new environmental requirements or assessing liabilities for past environmental damage. Significant environmental legislation may not be put in place until several years after the transition to a market economy, when the economy has stabilized and recovery is on its way. Given the extent to which environmental degradation has already occurred in Cuba, however, the enactment of wide-ranging environmental legislation is likely to be inevitable. In addition, Cuba's growing tourism industry will require a high level of environmental quality control (i.e. clean beaches, unpolluted coastal waters, etc.), and therefore increased environmental regulation.

The need to comply with Cuba's environmental laws will be a factor that sophisticated foreign investors will include in their investment decision. Pre-investment planning often includes examining existing and imminent environmental laws to find ways of structuring the investment so that compliance with the laws is achieved while minimizing its impact on the cost of the projects. Adequate environmental compliance plans help prevent environmental disasters, allow proposed projects to proceed successfully through the pre-approval review process, and, in the event of a legal challenge, help convince the decision-maker that the project meets environmental standards.

Additional environmental compliance issues will be faced by foreign investors who become involved in the privatization of state enterprises. The main questions in those cases will have to do with the extent to which an investor acquiring a state enterprise will assume liability for environmental damage or hazards created by the enterprise while in the hands of the state.

In Czechoslovakia, for example, uncertainty over responsibility for environmental liabilities incurred in the past by state enterprises raised concerns with foreign investors that participated in the country's privatization program. The Czech government has tried to deal with this issue by promising investors limited indemnification for environmental liabilities which have not been identified at the time a venture is negotiated. Cuba will need to develop clear rules for determining the extent to which investors acquiring privatized enterprises are subject to liability for past environmental damage.

6. Alternative Dispute Resolution

The existence of effective dispute resolution mechanisms is an important factor in a foreign investment decision, since the expectation of prompt and fair resolution of disputes bears on the safety of an investment. An effective judicial system in Cuba would probably go a long way towards assuring an investor that his investment is secure. However, the Cuban judicial system will probably be overloaded and have little experience in adjudicating international business disputes during the country's transition to a market economy. Thus, foreign investors will likely favor contractually-agreed arbitration to resolve disputes that arise from doing business in Cuba.

Arbitration is increasingly used to settle international investment disputes. In the Western Hemisphere, three treaties establish substantive law and procedures for international arbitration: the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("U.N. Convention"), the Inter-American Convention on International Commercial Arbitration ("Inter-American Convention"), and the ICSID Convention, examined earlier in this paper. The Inter-American Convention essentially replicates the U. N. Convention, with the major difference being that the Inter-American Convention provides for a mechanism to administer international commercial arbitrations in the Western Hemisphere and, in addition, provides for rules of procedure. The ICSID Convention, as mentioned earlier, only applies to disputes between investors and the host state.

Cuba's accession to one or all three international arbitration conventions (which are not mutually exclusive) would set up a viable dispute resolution mechanism to handle foreign investors' claims during Cuba's transition to a market economy. Such a mechanism would be particularly well-suited to the transition period, given that the Cuban judiciary system will then be ill-equipped to deal with foreign investors' disputes.

CONCLUSIONS

Cuba has introduced a number of economic reforms in the last few years, and is likely to implement additional measures to create a favorable environment for foreign investment. Cuba has also sought to make attractive opportunities available to foreign investors, and has succeeded in bringing in investments in certain areas of its economy, notably tourism. A new foreign investment code, providing for additional liberalization of the investment rules, may soon be enacted.

Despite these advances, foreign investment in Cuba remains a difficult, high risk proposition. Unless and until there is a significant relaxation of the economic controls and investment restrictions that are now in place, it is unlikely that there will be a sufficient influx of foreign investment to turn the economy around. Accordingly, Cuba's political leaders during the transition should place a high priority on creating a foreign investment structure—in the form of a modern Foreign Investment Code, related laws, and appropriate administrative mechanisms—that make the decision of a prospective foreign investor to go into Cuba easy to reach and just as simple to carry out.