

Cuba : foreign investment and salaries	Titulo
Díaz Vázquez, Julio A. - Autor/a;	Autor(es)
En: From the island : providing unique perspectives of events in Cuba no. 27. (abril 2015). Washington D.C. : Cuba Study Group, 2015.	En:
Washington DC	Lugar
Cuba Study Group	Editorial/Editor
2015	Fecha
	Colección
Inversiones extranjeras; Salarios; Economía; Caribe; Cuba;	Temas
Artículo	Tipo de documento
* http://biblioteca.clacso.edu.ar/Cuba/ciei-uh/20150428094918/csgEng.pdf	URL
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Cuba: Foreign Investment and Salaries

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APRIL 1, 2015

I
The salary system applicable to foreign investments in Cuba requires clarification from an objective point of view, removed from ideologies or politics. The core of the agreements of the Cuban VI Congress of the Communist Party (held April 18, 2011) contain 313 Guidelines for the Economic and Social Politics of the Party and the Revolution and provided the basis for the “Updating of the Economic Model.” Law 188 of foreign investment (March 29, 2014) which took effect June 29, 2014, replaced Law 77 (September 5, 1995) and represented a substantial change for the future new economic structure in the island.

Foreign Investment companies were authorized in the Cuban economy with the approval of Decree-Law No. 50 (February 15, 1982) and considered as a *complement* to the investment effort developed by the country. They went into effect when an agreement was reached with Sol Melia (1988), from Spain, for the construction of a hotel in Varadero, which was inaugurated in 1990.

But in 1990 Cuba started a never before seen path in the managing of the economy, known as the *Special Period in Times of Peace*. During this period, in 1995, Law No. 77 was enacted¹. We will study some of its sections and the aspects that differentiate it from Law No. 118 of 2014 with regards to salaries.

II
Law No. 77 served as the basis to gradually increase the presence of foreign capital in the national economy as a *complement*. But the presence of foreign capital had its special characteristics: it isolated external foreign investments; created the instruments to make that separation effective, and used the U.S. dollar in the execution of all projects, which made the Cuban case *sui generis* in the absorption of international capital.

¹ See Julio A. Díaz Vázquez, “Las inversiones extranjeras en Cuba” Centro de Investigaciones de Economía Internacional, La Habana, 1999.

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Law No. 77 considered three main directions. The first direction highlighted Cuba's human and material infrastructure. The second emphasized the relative advantage related to Cuba's human capital. In the labor market for instance, it was determined that in the area of tourism the benefits obtained in the Island were higher than those obtained in similar areas by Spain or in the Caribbean. The third direction highlighted the competitive elements of the special characteristics of the natural resources to promote tourism, opened to FDI since 1988. Additionally, it showed a social balance that resisted with political and social stability the U.S. embargo for more than half a century.

But in Law No. 77 the contribution of FDI's was limited, since it excluded sectors considered to be key, such as sugar and agriculture. Moreover, FDI's were formalized on the basis of a specific agreement for each business proposed, while the FDI's did not participate in the areas of production, management and economic direction.

The creation and operation of mixed industrial companies raised doubts with regards to the life of each contract and with regards to the control by each of the participants in a project. This led foreign investors to believe that this created potential competitors, and granted strong points when competing for other investment options in the area.

Other inconveniences included institutional regulations. Among them, the analysis and approval of FDI's proposed projects. The approval of FDI's was concentrated in the acting Committee, the Ministry of Foreign Investment and Collaboration, and the entity attached to the Executive Committee of the Council of Ministers (CECM), a process that reduced the role of the local company or ministry as valid connections for the potential foreign investor.

The inertia of the centralized model also affected the evaluation of the resources shared by the parties. In addition to the lack of experience or difficulty to distinguish between obtaining the financing to make an investment, and the responsibility of the parties and the corresponding business risk. It was also known that there was a monopoly in the procedures to open any type of foreign business in the Island. Moreover, establishing and operating a business in the island was never free from bureaucratic costs. The other issues dealt with the order of the documentation or the absence of professionalism in preliminary contracts, etc.

The negotiations in the area of tourism were more dynamic, which seemed to be the result of the experience acquired, the flexibility in the applicable norms, the priority given to the area and the fact that from the beginning the management methods employed were more expeditious. Caution was used in the case of proposals from businessmen that were not backed by intention or resources.

In turn, Law No. 77 included the direct promotion of the IDE's in the island, which sectors were authorized to associate with foreign capital in several forms, and contemplated exclusive external investments. Only a small electrical plant was approved in the Isla de la Juventud and excluded all foreign investments in the areas of public health, education and defense, excluding their management system.

Finally, in the area of labor, a bridge hiring entity divided labor relations, which were not direct relations between the foreign employer and the worker. The intermediary agency received the employees' payment in U.S. dollars and the employee in turn, received the payment in local currency (CUP). This affected and reduced the encouraging character of the salary, and casted doubts with regards to the fidelity of the employee to the investor, or to the commercial branch of the business located in the country. It also prohibited local personnel from representing foreign companies.

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Finally, this legislation caused foreign investors to start paying certain amounts in U.S. dollars to some of their employees under the table, or to some of its products. Later, those who received these supplements were made to declare them and pay as taxes 10% over such income.

III

In replacing Law number 77 (May 9, 1995), Law No. 118 offered a wider scope for the participation of FDI's in the Cuban economy, and established political conditions, among them: contributing to solve the structural problems of the economy, connecting with long term development programs (under preparation), promoting the development of comprehensive projects that generate productive chains, contributing to the change of the energy matrix and finally facilitating the access to advanced technologies that increase the productivity of the work.

Exceptionally, a FDI may participate in private legal economic structures with companies of Cuban capital. Law No. 118 incorporates the FDI's to the operation of the new "Economic-Social Model" of the "Prosperous and Sustainable Socialism" born in Cuba. This shall be one of the elements of the mixed economy in development in the country, together with government property, agricultural cooperatives, service cooperatives and non-governmental actors such as "*cuentapropistas*."

Law No. 118 provides that no exclusive rights will be granted over the Cuban market. Connected to Law No. 118 is the Social Development Area of Mariel (ZEDM for its Spanish initials), which covers 465 square kilometers and a modern infrastructure. This area will include a dock capable of handling 800 hundred thousand containers a year, and with space for the docking of cargo ships with a capacity of more than 200 thousand metric tons (post Panamax ships). Decree Law 313 defines tax incentives and details of the labor for the ZEDM.

The legal framework approved by law No. 118 has been standardized by Decree Law No. 325/2014 which regulated the Foreign Investment Law. Resolutions No 128/2014 and 129/2014 of the Ministry of Foreign Commerce and Foreign Investment, as well as Resolution 16/2014 from the Ministry of Labor and Social Security, and Resolutions 46/2014 and 47/2014 of the Central Bank of Cuba, which exempts them from payment of the sales or service tax during the first year of operations, and later establishes a bonus of 50% to whole sales and services.

IV

In the employment of Cuban labor, the Ministry of Labor and Social Security, through Resolution 16 (which replaced Resolution No. 23/2003), established the labor laws for FDI's in areas such as the negotiations to determine the amount to pay for the labor force, the elements that must be taken into consideration to determine the salary of the workers, and their return to the employing entity.

The Resolution also identified eleven bridge hiring companies, with a differential salary treatment, and although the main purpose of these agencies is not the collection of funds, those who work in the ZEDM shall receive 80% of the salary agreed between the employment agency and the concessionaries or Users.²

The salary to be received by the worker, according to the contract executed with the employment agency, shall be in local currency (CUP), at an exchange rate of 1 to 10. This will apply until 2017, at which time the monetary unification shall begin in Cuba,³ and the workers shall pay a tax on the salary received of 5%. In any case, the salary of the worker would always be higher than the one he could have received as state employee.

² Concessionaries are the foreign investors, and Users refer to any individual or company resident in the national territory.

³ Currently, two different currencies circulate in Cuba with different exchange rates: for the CUP the exchange rate on 1 for 24-25, for sale or purchase, while for the CUC (convertible peso at the equal exchange with the US dollar) is 1 per 1 in the government.

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The salary system shall apply to those who work in activities connected to the FDI's, including the ZEDM, and must be permanent Cuban residents, whether Cuban or foreign nationals. The hiring of workers working for concessionaries or Users of the Zone is made through employment agencies in accordance with the contract executed. The concessionaries and Users may directly contract foreign individuals who are not permanent residents of Cuba to perform management or technical positions, after the approval by the competent authority.

The individuals described above may remain and work in the country provided they comply with the immigration, tax and labor regulations. Foreign workers who are permanent residents in Cuba must establish previously a labor relationship with the employing entity. All issues related to contracts, labor discipline, solutions of labor conflicts, collective labor contracts, internal regulations, social security, annual paid vacation, overtime, payment for work on Holidays or weekends, protection, safety and health at the workplace, material responsibility, shall be governed by the applicable legislation in force for these areas.

The contract to provide labor force to the Concessionaire or User, executed with the hiring company, shall contain the following: names and domicile of the parties and their position, name and corporate domicile of the Concessionaire or User, and Cuban company, object of the contract, specifying positions, number of workers, payment for the service to perform, return or replacement of the worker, obligations of the contractor as provided in the Regulation of Decree Law No. 313 and the current labor legislation, duration and revision of the contract, date when the contract becomes effective and signature of the parties and other issues required by the parties.

The presentation by the Concessionaire or User of the legal authorization document to execute the activity authorized is indispensable for the execution of the contract, along with the accreditation of its representative and the work permit, in accordance with the applicable legislation. The payment for labor force services shall be agreed between the hiring company and the Concessionaire or User.

When the worker fails to fulfill the interests of the Concessionaire or User he may be returned to the Cuban employment agency, after compensating the respective entity. If necessary, another worker may be requested as replacement. The compensation shall be paid to the entity selected only once, in accordance with the following: one month of payment for providing the worker for up to 9 years of service; two months for 10 to 19 years of service; three months for 20 to 25 years of service; 4 months for 26 to 30 years of service and 5 months for more than 30 years of service.

When the return of the worker takes place at the request of the worker, no compensation payment shall be owed. The returned worker shall be subject to the legal provisions applicable to released workers. The amount to pay for the labor force takes into account: salaries for similar positions in entities of the same branch or sector in the same geographical area of the Concessionaire or User; salaries paid to Cuban workers, plus paid vacations and expenses incurred by the bridge hiring company to guarantee the supply of qualified labor force and the necessary recruiting, selection and training, among other aspects. This amount represents the payment and is determined in the contract between the Cuban entity and the Concessionaire or User.

The salary to collect for the workers shall depend on the positions requested by the Concessionaires or Users. The bridge hiring company authorized by the Ministry of Labor and Social Security shall take into consideration the complexity, labor conditions, and additional requirements of the respective positions, the form of payment based on performance, the coefficient established and the amounts obtained for the supply of the labor force.

The following factors are taken into consideration when determining the salaries of Cuban Concessionaries or Users: there are no internal salary regulations, nor from the country of origin of the foreign entity. Therefore, the salaries shall be connected to the results of the entity. The salary increases for Concessionaries and Users shall be determined by connecting the salaries of the entities with the compliance with certain directives. The

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directors of the companies shall determine the applicable payment system for returns. Salaries are determined at the time of the negotiations on the basis of the average salary on the province of Havana at the closing of the previous year.

Finally, the Social Security contribution shall be 14%, and shall be subject to other taxes and payment obligations. The FDI's are exempted from the payment of taxes for the use of labor force and from the local development contribution. With regards to foreign personnel, is still applicable the exemption of the payment of taxes on personal income of the foreign partners in mixed companies or for portion on joint venture contracts.

V

In summary, the regulations applicable to the FDI's have been the object of several criticisms. One of them is related to the fact that Law No 118 from 2014 should have been just an "Investment Law" to provide room for local investors. Other comments from abroad have claimed that the Law is in violation of the regulations of the International Labor Organization (ILO), since for example; it fails to contemplate the creation of labor unions.

Another complaint refers to the different entities controlling foreign investments. These include the Chamber of Commerce, Ministry of Foreign Commerce and Foreign Investments, diplomatic offices, abroad and other related entities, without specifying them in detail.

Consequently, the functions of preparation and approval of sectorial policies are divided between the Implementation and Development Committee (CPID for its Spanish initials), Ministry entities and Higher Organization of Corporate Direction (OSDE for its Spanish Initials). The design of the operation may cause conflict of interests given that the policies proposed (Ministry and OSDE) are approved at a higher level, and implemented by the appropriate OSDE.

The determination of the salaries incorporated in the amounts to be submitted to foreign investors fail to provide an explanation that could be used as reference for similar categories for the investor. Evidently, the presence of the Cuban hiring company eliminates the possible advantages that the lower cost of the labor force in Cuba represent for foreign investors.

Finally, the brief summary of the economic adjustments made in Cuba in the last 25 years, including the acceptance of the FDI's during the "Special Period" evidences four basic issues. First the relevance of the centralized model applied in the Island for thirty years. Another is the rejection of the economic relations that organically integrate the market. Third, all measures applied in the context of the "Updating of the Economic Model" have been filled with some type of "tab" that maintains state control. Fourth, as a rule, the political-ideological pragmatism has governed its creation.



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